Supreme Court, U.S.
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No. _____

In The
# Supreme Court Of The United States
October Term, 1995

LEP GROUP PLC,
*Petitioner*

v.

ITOBA LIMITED,
*Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## PETITION FOR WRIT OF CERTIORARI WITH ATTACHED APPENDIX

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## QUESTIONS PRESENTED FOR REVIEW

1. Whether the Securities Exchange Act of 1934 applies to the sale of foreign securities by a foreign corporation to another foreign corporation on a foreign stock exchange.

2. Whether a dispute arising out of the purchase of foreign securities by a foreign corporation from another foreign corporation on the London Stock Exchange is subject to the application of United States law under the Securities Exchange Act of 1934 based on statements filed with the Securities & Exchange Commission for purposes of registering American Depository Shares of the securities involved.

3. Whether the alleged reliance on Securities and Exchange Commission filings by the foreign corporate parent of the purchasing corporation, in recommending the purchase to its subsidiary, is sufficient to establish subject matter jurisdiction notwithstanding that the purchasing corporation knew nothing of the filings or of its parent's alleged reliance on them.

4. Whether the detrimental effect of allegedly fraudulent conduct in the sale of foreign securities outside the United States on American parties other than the purchasers of the securities is sufficient to establish subject matter jurisdiction under the Securities Exchange Act of 1934.

## PARTIES TO PROCEEDINGS IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Itoba Limited, Plaintiff

LEP Group PLC,[1]/ Defendant

William R. Berkley, Defendant

John L. Read, Defendant

Peter J. Grant, Defendant

John R. East, Defendant

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1/ There are no parent corporations or non-wholly owned subsidiaries of LEP Group PLC.

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## OPINIONS BELOW

The opinion of the District Court for the District of Connecticut (App. at 1a) is unreported. The opinion of the Court of Appeals for the Second Circuit (App. at 19a) is reported at 54 F.3d 118 (1995).

## JURISDICTION

The judgment of the United States Court of Appeals for the Second Circuit was entered on May 15, 1995. Petitioner timely filed a Petition for Rehearing pursuant to Rule 40 of the Federal Rules of Appellate Procedure. The Court below entered an order denying the petition on July 14, 1995. (App. at 33a) This Petition is filed within 90 days of that date. The jurisdiction of this Court to review the judgment on petition for certiorari rests upon Section 1254(1) of the Judicial Code, 28 U.S.C. § 1254(1).

## STATUTES AND REGULATIONS INVOLVED

The relevant statutory provisions are the Securities Exchange Act of 1934, as amended, Sections 10(b) (15 U.S.C. § 78j(b)) and 27 (15 U.S.C. § 78aa) and Rule 10b-5 thereunder (17 C.F.R. § 240.10b-5). They are reprinted at pages 34a-36a of the Appendix.

## STATEMENT OF THE CASE

This case involves the open market purchase, by a foreign corporation, on a foreign exchange, of securities issued abroad by another foreign corporation. Itoba Limited ("Itoba"), a Channel Islands buyer of shares in LEP Group plc ("LEP Group"), an English company, claims that it was defrauded into making purchases by several statements of LEP Group's chief executive officer, which were included in reports and press releases filed with the Securities & Exchange Commission ("SEC"). All of the statements allegedly relied upon by Itoba in making the purchases originated in England; and Itoba, when it made the purchases, had no knowledge that LEP Group had placed any of these statements on file with the SEC.

The primary trading market for LEP Group's ordinary shares is the International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd. (the "London Exchange"). In 1988, LEP Group deposited less than 10% of its ordinary shares in an American depository as an accommodation for the 1987 purchase of an American company. The depository in turn issued an American Depository Receipt (ADR) for each five shares of LEP Group on deposit. The ADRs were traded in the form of American Depository Shares (ADS) on the National Association of Securities Dealers Automated Quotation System ("NASDAQ"). Consequently, LEP Group was required to meet certain reporting and disclosure requirements with the SEC.

The entire contents of LEP Group's SEC filings originated in England. LEP Group modified its annual report and accounts in England to comply with accounting standards in the United States. The only American involvement was the receipt of these filings by the SEC. The narrative statements by the company chairman were taken directly from LEP Group's English annual report.

Significant press announcements, filed with the SEC also originated in England, though in some cases they were given an American dateline when released in the United States.

Itoba did not purchase LEP Group ADRs; nor did it review, know of, or even hear of any LEP Group SEC filings throughout the six months that it purchased LEP Group ordinary shares on the London Exchange. Itoba had owned a small number of LEP Group shares for several years and had been receiving LEP Group's annual reports and accounts, sent from London to Itoba's Guernsey headquarters. Itoba claims that it purchased the shares based on the recommendation of David Hammond, deputy chairman of A.D.T. Limited ("ADT") given to David Crespell, an Itoba director. ADT, a Bermuda corporation, is Itoba's corporate parent but is not a party to this action. Although it appears that ADT financed the purchase of LEP Group ordinary shares by Itoba, Itoba bought and retained all of the shares in question.

Commencing in June 1990, over a six month period, Itoba purchased 27% of LEP Group's outstanding ordinary shares as they became available on the London Exchange. During this six month period, despite the purchasing activity of Itoba, the price of LEP Group shares dropped approximately 30%. The value of LEP Group shares continued to drop throughout 1991 until the summer of 1992 when LEP Group entered into a plan of reorganization. Itoba claims that its entire investment had diminished in value by 97% as of September 22, 1992.

Itoba has taken the position that it based its purchase of LEP Group securities on the recommendation of David Hammond, deputy chairman of ADT, made in consultation with Michael Ashcroft, chairman and chief executive officer of ADT. Mr. Ashcroft and Mr. Hammond, in turn, relied upon the assessment of an ADT executive accountant, Nicholas W. Wells, regarding the merits of investing in

LEP Group. Mr. Wells, in his analysis, made use of a report produced by S.G. Warburg, a London investment bank. The Warburg report had been commissioned by Canadian Pacific, a Canadian company unrelated to LEP Group or ADT. Canadian Pacific was not involved in the transactions at issue, but had also been exploring the idea of investing in LEP Group. Canadian Pacific made the Warburg report available to Mr. Wells. The Warburg report purports to rely on LEP Group's United Kingdom annual reports and circular to shareholders, its shareholder register, brokers' reports, and the LEP Group's 1988 Form 20-F filed with the SEC. Mr. Wells states that he supplemented the Warburg report with his own copy of the 1988 Form 20-F obtained from Canadian Pacific.

The alleged reliance on LEP Group's SEC filings thus derives from a London investment bank's use of the 1988 Form 20-F to prepare a report for a Canadian company, who then made the report available to an executive accountant at Itoba's corporate parent, who allegedly relied upon it in reporting to his superiors, who in turn made a purchase recommendation to an Itoba director. Mr. Wells, the ADT executive accountant, was the last person in this chain who actually reviewed any SEC filings, and Mr. Crespell and Itoba were unaware that any such filings existed.

Although Itoba has attempted to blur the distinction between itself and ADT for purposes of litigating this issue, the record conclusively establishes Itoba's independent existence and autonomy in engaging in the purchase of LEP Group ordinary shares. Itoba, not ADT, made the decision to invest. Itoba acted through its own board of directors which had the authority to analyze an ADT recommendation and determine whether to act in accordance with that recommendation. The Itoba directors had the responsibility to make an independent decision regarding any recommendation coming from ADT. There

were no limits placed on the extent of any inquiry the Itoba directors might decide to undertake before acting on a recommendation.

Itoba brought this action against LEP Group in the United States District Court for the District of Connecticut in September 1992. Itoba asserted claims against LEP Group and several of its directors and officers pursuant to Section 27 of the Securities Exchange Act of 1934[2]/(the "Exchange Act"). In its Complaint, Itoba identified specific statements contained in the SEC filings which it claims were misleading. The affidavits of Wells and Hammond make no mention of these statements, but broadly state that Mr. Wells' analysis generally relied on the SEC filings in addition to other materials. The Complaint alleges that LEP Group's SEC filings failed to disclose problems with the company's American real estate investments, a trading alliance corporation, and an investment in a Tanzanian gold mine. The Complaint does not allege that any of these dealings involved fraudulent conduct or a violation of any law, rule, or bylaw. The Complaint also does not allege that a single figure in LEP Group's financial statements, reports, and press releases as filed with the SEC is erroneous, incomplete, misleading, or not in accordance with generally accepted accounting principles, practices, and standards.[3]/

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2/ Itoba also asserted common law claims against the defendants, but withdrew those claims in the District Court. (R. at ___)

3/ In fact, the Notes to the Accounts of the 1988 annual report specifically revealed the extent of LEP Group's exposure in the U.S. properties. Item (i) of Note 1 states that the accounts have been prepared under the historical cost convention, modified to include the

(continued...)

Itoba alleges only that the narrative statements of the company chairman in LEP Group's public reports, reflecting his satisfactory and optimistic assessment of the company's prospects, were fraudulent. While the chairman's 1988 and 1989 assessments did prove to be inaccurate in 1991 and 1992, Itoba's Complaint does not allege that, prior to its purchases of LEP Group shares in 1990, LEP Group knew or should have known that its optimism was unjustified.

In response to Itoba's Complaint, all defendants filed motions to dismiss the case, pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, for lack of subject matter jurisdiction or, in the alternative, on the ground of forum non conveniens. The District Court (Eginton, J.) referred the matter to Magistrate Judge Margolis who rendered a recommended ruling dismissing the case as to all defendants. (App. at 1a) The District Court adopted the Magistrate's recommended ruling over the objection of

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3(...continued)

revaluation of certain fixed assets. Item (xii) of Note 1, entitled "Property Joint Ventures," states that all costs incurred in development are capitalized. Item (xiii) of Note 1, entitled "Development Properties," states that projects are periodically valued, with any gains or losses being taken to reserves. Note 14 provides disclosure of the net amount of property joint venture 22,759,000 pounds -- and discloses the outstanding lines of credits relating to such property -- 38,035,000. These notes would allow the reader to know that LEP Group had made substantial investments in property joint ventures and that the outstanding lines of credit were greater than the assets (at a cost valuation) and that the cost might not reflect the fair market value.

Itoba.[4]/ (App. at 17a) On appeal to the United States Court of Appeals for the Second Circuit, the District Court's decision was reversed and remanded for a trial on the issues raised by the defendant's Rule 12(b) motion. (App. at 19a)

## ARGUMENT

### I. INTRODUCTION

This Court should review the decision of the Second Circuit Court of Appeals because it has vastly expanded the application of the Exchange Act to foreign securities transactions. By drastically diluting established standards, developed principally by the Second Circuit, the Court of Appeals has by this decision given rise to an important question of federal law which this Court should address. S.Ct. R. 10.1(c) The extent to which American courts should provide a forum for the resolution of disputes arising out of foreign securities transactions, based on remote and indirect American contact with the parties or the transaction, will significantly influence the willingness of foreign corporations to have any contact with American businesses. Moreover, the course adopted by the Court of Appeals will attract to this country disputes which foreign jurisdictions should more appropriately resolve.

This Court has never addressed the extraterritorial application of the anti-fraud provisions of the Exchange Act in the context of a private right of action. This Court has addressed the extraterritoriality of other statutes and reached varying conclusions. See EEOC v. Arabian American Oil Co., 499 U.S. 244, 111 S.Ct. 1227 (1991) (deciding against

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4/ The District Court did not reach the issue of forum non conveniens in light of its conclusion on the issue of subject matter jurisdiction.

extraterritorial application of civil rights laws); Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 704, 82 S.Ct. 1404, 1413, 8 L.Ed.2d 777 (1962) (deciding in favor of extraterritoriality in the context of the Sherman Anti-trust Act). Even when this Court has concluded that a statute has extraterritorial application, the Court has grappled with the appropriate role comity should play in defining the limits of the extraterritorial application of American law. Hartford Fire Ins. Co. v. California, 113 S.Ct. 2891, 2910, 125 L.Ed.2d 612 (1993) (5-4 decision declining to consider comity in the absence of a "true conflict" between the laws and policies of the countries involved).

Although it has been generally accepted by the lower courts that the Securities Exchange Act of 1934 (the "Exchange Act") has some extraterritorial application, it is by no means clear that Congress intended any extraterritorial effect. See Zoelsch v. Arthur Anderson & Co., 824 F.2d 27, 30 (D.C. Cir. 1987); Sachs, The International Reach of Rule 10b-5: The Myth of Congressional Silence, 28 Columbia J. of Transnat'l L. 677 (1990). In EEOC v. Arabian American Oil Co., the court reiterated a "longstanding principle of American law 'that legislation of congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'" EEOC, 111 S.Ct. at 1230, quoting Foley Brothers, Inc. v. Filardo, 336 U.S. 281, 284-85, 69 S.Ct. 575, 577, 93 L.Ed. 680 (1949). To overcome this presumption, the party advocating extraterritoriality must demonstrate that the statute at issue contains "'the affirmative intention of Congress clearly expressed'" to so apply the law. Id., quoting, Benz v. Compania Naviera Hidalgo, S.A., 353 U.S. 138, 147, 77 S.Ct. 699, 704, 1 L.Ed.2d 709 (1957).

The lower courts have completely overlooked this principle of American law when considering the extraterritorial application of the Exchange Act, and its anti-

fraud provisions in particular.[5]/ Instead, in order to limit the scope of extraterritorial application of the Exchange Act, the courts have engaged in a jurisdictional analysis employing two distinct tests to establish the requisite threshold of American involvement in a particular transaction, the "conduct test", and the "effects test". Under the "conduct test" a federal court has subject matter jurisdiction over allegations of fraud arising out of foreign securities transactions if the defendant's conduct in the United States was more than merely preparatory to the fraud, and particular acts or culpable failures to act within the United States directly caused losses to foreign investors. Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326, 1333-39 (2d Cir. 1972). Under the "effects test", a federal court has jurisdiction where illegal activity abroad causes injury to American purchasers or sellers of securities. Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 261-62 (2d Cir. 1989). Neither test has included considerations of comity in its analysis. In the leading case on this issue, Judge Friendly articulated the heretofore accepted framework of analysis as follows:

> [T]he anti-fraud provisions of the federal securities laws:
>
> (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material

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5/ In Zoelsch, the court resisted the temptation to consider this principle in deference to the perceived expertise of the Second Circuit in these matters and with a desire to avoid further division among the Circuits regarding the extraterritorial application of the Exchange Act. Zoelsch, 824 F.2d at 32-33.

importance occurred in this country; and

(2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but

(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.

Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 993 (2d Cir. 1975) cert. denied, 423 U.S. 1018, 96 S.Ct. 453, 46 L.Ed.2d 389.

Neither the "conduct test" nor the "effects test" are sufficient to establish subject matter jurisdiction in this case. Citing no precedent, however, the Court of Appeals purported to apply "[a]n admixture or combination of the two . . ." in order to justify the assertion of jurisdiction. (App. at 24a) The Court of Appeals stretched the traditional limits of both tests, added together the elements which satisfied each test as modified, and concluded that there was "[a] sufficient combination of ingredients of the conduct and effects tests . . ." to warrant the exercise of jurisdiction. (App. at 30a) As a consequence the Court of Appeals has created a new doctrine under which any foreign corporation must anticipate that any purchaser of its securities, anywhere in the world, who received any advice from anyone, American or not, which was derived in any manner and at any level of indirectness from information that appeared in an SEC filing, can sue in an American court,

provided some shareholder of the purchaser (or as in this case a shareholder of the purchaser's corporate parent) is American. The Court of Appeals' decision is in conflict not only with the decisions of other courts of appeals, but also with its own prior decisions to the extent that it has diluted and departed from the previously applicable standards. S.Ct. R. 10.1(a). This Court's review of the Court of Appeals' decision is necessary in order to finally address the extraterritorial application of the Exchange Act and to assign an appropriate role to comity in this context.

## II. THE LANGUAGE OF THE EXCHANGE ACT DOES NOT DIRECTLY DISCLOSE AN INTENTION TO GIVE IT EXTRATERRITORIAL AFFECT.

This Court has recently observed that "[w]e have repeatedly held that even statutes that contain broad language in their definitions of 'commerce' that expressly refer to '***foreign*** commerce' do not apply abroad." EEOC v. Arabian American Oil Co., 111 S.Ct. at 1232, citing New York Central R. Co. v. Chisolm, 268 U.S. 29, 45 S.Ct. 402, 69 L.Ed. 828 (1925) (refusing to give extraterritorial application to the Federal Employees Liability Act (FELA), 45 U.S.C. § 51 et seq.) (emphasis in original). In Chisolm, the Court considered FELA's prescriptive language applying its provisions to commerce between "any of the States or territories and any foreign nation or nations." 45 U.S.C. § 51. The Chisolm Court concluded that the Act "contains no words which definitely disclose an intention to give it extraterritorial affect." Chisolm, 268 U.S. at 31. In contrast, this Court held that the Lanham Act does apply extraterritorially in Steele v. Bulova Watch Co., 344 U.S. 280, 286, 73 S.Ct. 252, 256, 97 L.Ed. 319 (1952). The Court based its conclusion on the Lanham Act's definition of "commerce" as "all commerce which may lawfully be

regulated by Congress." Steele, 344 U.S. at 285-87. Congress's authority in this regard derives from Article I, Section 8, cl. 3 of the Constitution which includes the authority to regulate "commerce with foreign nations."

The language used by Congress to prescribe the scope of the applicability of the Exchange Act is virtually identical to the language considered in Chisolm. In its statement of legislative purpose the Exchange Act expresses Congress' concern with the "national market system," not the international market system. 15 U.S.C. § 78b. This is notwithstanding the fact that the internationalization of the securities market had occurred prior to enactment of the Exchange Act. See Sachs, supra at 691-94. The Exchange Act defines "interstate commerce" as "[t]rade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof . . . ." 15 U.S.C. § 78c (17). This definition places limits on the applicability of the substantive provisions of the Exchange Act, in contrast to the language of the Lanham Act which clearly expresses an intent to extend the authority of Congress to its constitutionally permissible limit. See Sachs, supra at 699-701.

Because Congress did not affirmatively express an intention to give the Exchange Act extraterritorial effect, the Court of Appeals has erroneously and inappropriately given the Exchange Act extraterritorial effect in this case.

## III. THE COURT OF APPEALS' EXTRATERRITORIAL APPLICATION OF THE EXCHANGE ACT EXTENDS BEYOND THE BOUNDS OF INTERNATIONAL COMITY.

Even if the Court of Appeals were correct in giving extraterritorial effect to the Exchange Act, the extent to which it has done so violates considerations of international

comity. The concept of international comity does not even enter into the Court of Appeals' analysis of this issue. However, even when Congress does give extraterritorial effect to a statute, it is presumed to have incorporated the limits of customary international law in its prescription. "[A]n act of Congress ought never to be construed to violate the law of nations if any other possible construction remains." Murray v. The Charming Betsey, 2 Cranch 64, 118, 2 L.Ed. 208 (1904) quoted in Hartford Fire Insurance Company v. California, 113 S.Ct. at 2919 (Scalia, J. dissenting).

Under an analysis which recognizes the considerations of international comity, the Exchange Act would not apply to the transactions at issue in this case. As noted by the Ninth Circuit Court of Appeals in Timberlane Lbr. Co. v. Bank of America, N.T. & S.A., 549 F.2d 597, 609 (9th Cir. 1976), "[i]t is evident that at some point the interests of the United States are too weak and the foreign harmony incentive for restraint too strong to justify an extraterritorial assertion of jurisdiction." The circumstances of this case are beyond that point if the relevant considerations are: the primary location of the activity in question, the citizenship of the parties involved and the interest of the English government in regulating its own securities market. All of the transactions at issue occurred on the London Exchange and involved English securities, an English company and a Channel Islands company. Those factors virtually dictate restraint on the extraterritorial application of the Exchange Act in this case. See Hartford Fire Ins. Co. v. California, 113 S.Ct. at 2920-2921 (Scalia, J. dissenting).

## IV. THERE IS NO SUBJECT MATTER JURISDICTION OVER THIS DISPUTE UNDER THE "CONDUCT TEST."

The Court of Appeals could not establish subject matter jurisdiction over this dispute under the traditional conduct test because LEP Group's activities in the United States were unrelated to the fraud alleged by Itoba. LEP Group's SEC filings had nothing to do with the ordinary shares traded on the London exchange and Itoba was unaware that such filings existed. The SEC filings were actually less than "merely preparatory" to the alleged fraud and did not "directly cause" the alleged fraud. Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975) cert. denied, 423 U.S. 1018, 96 S.Ct. 453, 46 L.Ed.2d 389; Alfadda v. Fenn, 935 F.2d 475 (2d Cir. 1991) cert. denied, 112 S.Ct. 638, 116 L.Ed.2d 656. In Bersch, the court stated "[w]e see no reason to extend [jurisdiction] where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison with those abroad." Bersch, 519 F.2d at 987. In a case decided the same day as Bersch, the Second Circuit explained why it had opened the doors of American courthouses to a limited set of fraud claims by foreign offshore purchasers. The concern is that the United States not "be used as a base for manufacturing fraudulent security devices for export, even when these are pedalled only to foreigners." IIT v. Vencap Limited, 519, F.2d 1001, 1017 (2d Cir. 1975). The focus is on "the wickedness of particular transactions and as to whether they were engineered from the United States." Vencap, 519 F.2d at 1018. The Second Circuit's "true concern was that we entertain suits by aliens only where conduct material to the completion of the fraud occurred in the United States." Psimenos v. E. F. Hutton & Co., Inc., 722 F.2d 1041, 1046 (2d Cir. 1983). Put another way, "if the essential core of the alleged fraud

took place" abroad, and the American activities "were clearly secondary and ancillary," there is no subject matter jurisdiction, and the action should be dismissed at its outset. Fidenas AG v. Compagnie International Pour L'Informatique CII, Honeywell Bull S.A., 606 F.2d 5, 8 (2d Cir. 1979).

In this case, all of the conduct at issue took place outside the United States with the exception of the actual filing of documents with the SEC. The entire transaction occurred between foreign companies, took place entirely on a foreign exchange and involved securities not available in the United States. As for the SEC filings, LEP Group prepared all of the documents in England, for the most part duplicating information previously released in England. While, as the Court of Appeals notes, the situs of document preparation should not be determinative of the jurisdictional issue, in a case with no substantive United States contact beyond the SEC filings, this fact places the incidental nature of LEP Group's United States' activity in clear focus. Inexplicably, however, the Court of Appeals found the SEC filings to be more than merely preparatory because they allegedly contained uncorrected nondisclosures which had a "deleterious effect . . . on the thousands of ADT shareholders in the United States." (App. at 29a) Thus the Court of Appeals merely substituted the effects test for this aspect of the conduct test.[6/]

In the course of its analysis, the Court of Appeals also abandoned the second aspect of the conduct test, the requirement that United States conduct be the direct cause of the alleged loss. As demonstrated above, LEP Group's SEC filings were several steps removed from the transactions at issue and Itoba did not even know of their

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6/ As discussed below, however, the Court of Appeals had to acknowledge that the effects test was itself insufficient to establish a basis for asserting jurisdiction.

existence throughout the entire six months that it purchased LEP Group ordinary shares. Even Mr. Hammond, ADT's deputy chairman who recommended the purchase to Itoba, never reviewed any SEC filings by LEP Group. While it is impossible to say that, in the chain of people and events which preceded the purchases, LEP Group's SEC filings played no role, in no sense were they a "direct cause" of the purchases. The Court of Appeals, recognizing this, fell back on the concept of derivative reliance and thus significantly diluted the requirement of direct causation. (App. at 25a-26a)

While derivative reliance may be sufficient to render conduct actionable, it is an altogether different question whether such reliance can operate to broaden the extraterritorial application of U.S. law to what is otherwise totally foreign activity. Otherwise, in every case of this nature, the jurisdictional issue will be inevitably and hopelessly enmeshed with the merits of the case. This is directly contrary to the purpose of establishing a jurisdictional threshold. As stated in Bersch, "When, as here, a court is confronted with transactions that on any view are predominately foreign, it must seek to determine whether Congress would have wished the precious resources of United States' courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries." Bersch, 519 F.2d at 985.

Thus, it is only by ignoring the requirement that allegedly fraudulent conduct be more than merely preparatory in nature and by severely diluting the requirement of direct causation, that the Court of Appeals was able to conclude that the facts of this case were sufficient to satisfy the conduct test to any degree. In fact, even under this radically distorted formulation of the conduct test, the Court of Appeals was compelled to rest its decision upon a "combination of ingredients of the conduct and effects tests . . . ." (App. at 30a)

## V. THERE IS NO SUBJECT MATTER JURISDICTION OVER THIS DISPUTE UNDER THE "EFFECTS TEST."

Under the "effects test", the federal courts do not assert jurisdiction over transactions that have only "remote and indirect affects in the United States . . ." Consolidated Gold Fields, PLC v. Minorco, SA, 871 F.2d, 252, 262 (2d Cir. 1989). To the extent that the Court of Appeals relied on the effects test to support its conclusion, it did so by substantively narrowing the scope of what is considered "remote and indirect." The key to finding jurisdiction under the effects test is that the targets of the alleged fraud by the foreign defendant are American. The Court found subject matter jurisdiction in Consolidated Gold Fields, notwithstanding the use of foreign nominees for American purchasers, because the involvement of American purchasers "was clearly a direct and foreseeable result of the conduct outside the territory of the United States." Consolidated Gold Fields, 871 F.2d at 262. If LEP Group stood accused in the present case of inducing Americans to overpay for LEP Group shares for fraudulent nondisclosures, the effects test would arguably confer jurisdiction even if LEP Group had engaged in no conduct at all in the United States. However, only where Americans are induced to buy or sell the foreign shares is there jurisdiction over foreign fraudulent conduct. Under the prior case law of the Second Circuit, there is no jurisdiction in an American court where "the fraud was practiced not on individual Americans who purchased securities but on the [corporation] in which they had invested." Consolidated Gold Fields, 871 F.2d at 263, quoting IIT v. Vencap Ltd, 519 F.2d, 1001, 1016 (2d Cir. 1975). In this case, Itoba's only shareholder, ADT, is also foreign. Thus, even expanding the prior case law to include shareholders of the purchasing corporation, there would be no effects in the

United States under this new formulation of the test. The Court of Appeals expanded the test even further by examining the effect on the shareholders of Itoba's shareholder. This precedent would make the federal courts the venue of choice for any company operating anywhere in the world which happens to have American shareholders. Such a result is directly contrary to the principles articulated in Bersch limiting application of the effects test to American purchasers or sellers of securities. Bersch, 519 F.2d at 993.

## VI. THE COURT OF APPEALS' DECISION IS IN CONFLICT WITH ITS OWN PRIOR DECISIONS AND THOSE OF OTHER COURTS OF APPEALS.

As the foregoing discussion reveals, the Court of Appeals' decision in this case marks a dramatic departure from its own prior decisions by diluting its own established standards. Under its decision the Court of Appeals would apply the Exchange Act to transactions which involve both insignificant conduct in the United States and insignificant effects in the United States. The decision emasculates both the conduct test and the effects test, leaving nothing but the unpredictable rough sense of justice a court might have as the guideline for determining whether the Exchange Act will apply to countless transactions taking place in international markets every day.

The decision is also in conflict with the decisions by other courts of appeals on this subject. The conduct test and the effects test have been applied in every Circuit that has addressed the question of extraterritorial jurisdiction. In Tamari v. Bache & Co.(Lebanon), 730 F.2d 1103 (7th Cir. 1984) and Zoelsch v. Arthur Anderson & Co., 824 F.2d 27 (D.C. Cir. 1987), the appellate courts adopted the Bersch formulation as applied by the Second Circuit itself. In SEC v. Kasser, 548 F.2d 109 (3d Cir. 1977), Continental Grain

(Australia) Pty. Ltd. v. Pacific Oilseeds, Inc., 592 F.2d 409 (8th Cir. 1979) and Grunenthal GmbH v. Hotz, 712 F.2d 421 (9th Cir. 1983), the courts of appeals modified the conduct and effects tests to confer jurisdiction where American conduct in furtherance of a fraudulent scheme directly caused a loss, but the conduct in the United States was not itself alleged to constitute the elements of a Rule 10b-5 violation. See Zoelsch, 824 F.2d at 31. No court, however, until this case, has added elements of the conduct test to elements of the effects test to find the Exchange Act applicable where it would not apply under either test taken separately. Thus, there is now conflict between the Second Circuit and all others which have ruled on the issue, and that rarest of circumstances, conflict between the latest decision of the Second Circuit and its own earlier decisions. Thus this decision warrants review by this Court. S.Ct. R. 10.1(a).

## VII. EVEN UNDER THE EXTENSIVELY BROADENED EXTRATERRITORIAL JURISDICTION ASSERTED UNDER THE COURT OF APPEALS' DECISION, IT WAS NECESSARY TO ALLOW ITOBA TO PIERCE ITS OWN CORPORATE VEIL IN ORDER TO REVERSE THE DISTRICT COURT.

The critical element relied upon by the Court of Appeals to support the assertion of jurisdiction in this case is the virtual substitution of ADT as party plaintiff in this case. As discussed above, ADT has no standing to pursue this claim, notwithstanding that it financed the transactions at issue. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 95, S.Ct. 1917, 44 L.Ed.2d 539 (1975). In its decision, the Court of Appeals has transgressed the well established principle that a court will not pierce the corporate veil at the request of those who created that veil. Schenley Distillers Corporation v. United States, 326 U.S.

432, 437, 66 S.Ct. 247, 90 L.Ed. 181 (1946). See Hartford Fire Ins. Co. v. California, 113 S.Ct. 2891, 2921, n. 10, 125 L.Ed.2d 612 (1993) (Scalia, J. dissenting) ADT established Itoba as an investment vehicle in the Channel Islands to take advantage of the favorable tax consequences of Channel Island investment companies. ADT did not purchase LEP Group shares itself because it wished to conceal its involvement in the purchase program. As this Court stated in Schenley, "While corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages . . . ." Schenley, 326 U.S. at 437. ADT incorporated Itoba in order to benefit from the generous tax laws of the Channel Islands. The Court of Appeals has allowed ADT to ignore that separate identity, which here presents itself as a disadvantage, in order to seek the benefit of the United States securities laws.

In City National Bank of Ft. Smith Arkansas v. Vanderboom, 422 F.2d 221 (8th Cir.) cert. denied, 399 U.S. 905, 90 S.Ct. 2196, 26 L.Ed.2d 560 1 (1970), a group of investors had caused their corporation, Investors Thrift Corporation (hereinafter "ITC") to purchase all the shares of American Homebuilders, Inc., (hereinafter "AHB"). The investors, alleging to have been defrauded in the process, brought a counterclaim under section 10b-5 and 10(b) when they were sued by banks who provided financing in connection with the purchase. The investors argued that they should be deemed defrauded purchasers of AHB for the purposes of the counterclaim because ITC the actual purchaser, was never an operating company and its corporate structure was a mere conduit which was convenient for the investors to use in making this purchase. The Eighth Circuit Court of Appeals rejected the argument. It recognized that the remedy of piercing the corporate veil

is used when the corporate entity itself was being used to defeat public convenience, justify wrong, protect fraud or defend crime. Id. The Court held, "[w]e feel the corporate integrity of ITC must be respected and not glibly and casually disregarded . . . therefore, we conclude that the defendant investors do not satisfy the 'purchaser-seller' standing requirement 10(b) and Rule 10b-5." Id.

As was the corporation in Vanderboom, Itoba is allegedly the defrauded party, not the defrauding party. Further, Itoba, not ADT, purchased the securities at issue. Finally, Itoba clearly has its own corporate structure and is not the alter ego of ADT. Itoba and ADT were very careful to recognize and honor Itoba's separate corporate identity. ADT did not have the ability, nor did it even try, to dominate and disregard Itoba's corporate form or its investment decisions. To the contrary, both companies went to great lengths to exercise their respective independence.

## CONCLUSION

Under its decision in this case, the Court of Appeals would extend the securities laws of the United States to govern transactions in which the parties have no reason to anticipate that U.S. law will apply. When a party sees the opportunity to bring a claim arising out of such a transaction in a United States Court, it will unhesitatingly do so. "As a moth is drawn to the light, so is a litigant drawn to the United States." Smith Kline & French Laboratories v. Bloch, 2 All E.R. 72, 74 (1983). Under the "admixture test" adopted in this case by the Court of Appeals nearly every foreign transaction of securities involving a company with some connection to the United States will subject all parties to the transaction to the prospect of litigation in the United States. This Court should review the Court of Appeals' decision to determine first, whether the Exchange Act authorizes any extraterritorial application and, second, if it does, whether the Court of Appeals has extended its application too far.


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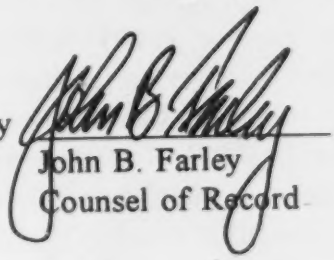
By 
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No. _____

In The

# Supreme Court Of The United States

October Term, 1995

LEP GROUP PLC,

*Petitioner*

v.

ITOBA LIMITED,

*Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

## APPENDIX

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

| | | |
|---|---|---|
| ITOBA LIMITED | : | 5:92CV00556(WWE) |
| V. | : | |
| LEP GROUP plc, ET AL | : | DATE:FEBRUARY 4, 1994 |

RECOMMENDED RULING ON
MOTIONS TO DISMISS

On September 22, 1992, plaintiff Itoba Limited ("Itoba") commenced this securities action with respect to allegedly fraudulent non-disclosure of facts in press releases and filings with the Securities and Exchange Commission ("SEC"] made by the defendant LEP Group plc ("LEP"). As set forth in its complaint, Itoba is a corporation organized under the laws of the States of Jersey, Channel Islands, with its principal place of business in St. Helier, Jersey, Channel Islands (¶8). Itoba is a wholly-owned subsidiary of ADT Limited ("ADT"), a corporation organized under the laws of Bermuda, with its principal place of business in Hamilton, Bermuda (id.). Defendant LEP is a corporation organized under the laws of England, with its registered office in Epsom, Surrey, England (id. ¶10). The four additional defendants are present or former directors of LEP -- William R. Berkley (who resides in Greenwich, Connecticut), John L. Read, Peter J. Grant and John R. East.[1]/

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1/ The action has been stayed as against defendant Read, a citizen of England who filed an Individual

(continued...)

After jurisdictional discovery was completed, on May 24, 1993, defendants LEP, Berkley, Grant and East filed motions to dismiss plaintiff's complaint on the grounds that this court lacks subject matter jurisdiction or, in the alternative, that the complaint should be dismissed under the doctrine of forum non conveniens (Dkt. #83-88).[2]/ On

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1(...continued)
Voluntary Arrangement under British law. See Ruling on Pending Discovery Motions, filed Apr. 5, 1993 (Dkt. #81), at 3-6.

2/ Defendant Berkley also filed an affidavit from his counsel, William G. McGuiness (Dkt. #85), to which the following four exhibits were attached: excerpts from the deposition of defendant Berkley, taken on March 10, 1993 ("Berkley Dep. Tr.11](Exh. 1); excerpts from the deposition of David B. Hammond, taken in London on November 24-25, 1992 ("Hammond Dep. Tr.11](Exh. 2); excerpts from the deposition of David L. Crespel, taken on February 10, 1993 ("Crespel Dep. Tr.11](Exh. 3); and excerpts from the telephone deposition of Peter W.S. Percival, taken on April 23, 1993 ("Percival Dep. Tr."](Exh. 4).

Attached to the motion of defendants LEP and East was an affidavit from their attorney, Jeffrey E. Glen (Dkt. #87), to which nine exhibits were attached: copy of LEP's Form 6-K, filed with the SEC on July 6, 1989 (Exh. 1) ; copy of LEP Is Form 6-K, dated October 12, 1989 (Exh. 2); copy of LEP's Form 6-K, dated April 20, 1990 (Exh. 3); copy of LEP's Form 20-F, dated June 29, 1990 (Exh. 4); additional excerpts from the Hammond deposition (Exh. 5); additional excerpts from the Crespel deposition (Exh.
(continued...)

June 28, 1993, plaintiff filed its brief in opposition and four affidavits (Dkt. ##90-94)[3]/ On July 17, 1993, defendants

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2(...continued)

6); excerpts from the deposition of defendant East, taken on February 25, 1993 (Exh. 7); excerpts from the deposition of defendant Read, taken on April 8, 1993 in Naples, Florida (Exh. 8); and additional excerpts from the Percival deposition (Exh. 9).

3/ The first affidavit was prepared by Hammond ["Hammond Aff't"](Dkt. #91), to which three exhibits were attached: copy of ADT's Form 20-F, filed with the SEC on May 21, 1992 (Exh. 1); copy of ADT's Form 10-K, dated March 31, 1993 (Exh. 2); and copy of LEP's Schedule 13D, filed with the SEC on October 18, 1990 (Exh. 3).

The second affidavit was prepared by Itobal's counsel, Mark C. Zauderer (Dkt. #92), to which the following twelve exhibits were attached: copy of plaintiff's complaint (Exh. 1); additional excerpts from the Hammond deposition (Exh. 2); additional excerpts from the Crespel deposition (Exh. 3); additional excerpts from the East deposition (Exh. 4); additional excerpts from the Berkley deposition (Exh. 5); additional excerpts from the Read deposition (Exh. 6); additional excerpts from the Percival deposition (Exh. 7) ; copy of LEP's Annual Report for 1991 (Exh. 8); copy of "Text of Address" given by David N. James, LEP's chairman, at the "Extraordinary General Meeting and Annual General Meeting" held on August 24, 1992 (Exh. 9); copy of an article appearing in the London Daily Telegraph on November 21, 1992 (Exh. 10); letter from plaintiff's

(continued...)

LEP, East, Berkley and Grant filed a reply brief (Dkt. #97)[4]/ On August 10, 1993, plaintiff filed a surreply brief

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3(...continued)

counsel to defense counsel, dated December 29, 1992 (Exh. 11); and Statement of Ruth Markland, a British solicitor (Exh. 12).

The third affidavit was prepared by defendant Grant (Dkt. #93), to which two charts were attached (Exh. 1), indicating LEP's price on NASDAQ and on the London Stock Daily Exchange, from December 1988 to December 1991.

The last affidavit was prepared by Nicholas Wells ["Wells Aff't"](Dkt. #94), to which the following two exhibits were attached: a copy of the "Project Bavaria" report, dated December 1989 (Exh. 1) ; and copy of LEP's Form 20-F, dated June 29, 1989 (Exh. 2).

4/ Three exhibits were attached: additional excerpts from the Hammond deposition (Exh. A); additional excerpts from the Crespel deposition (Exh. B); and an affidavit from defense counsel, Jeffrey E. Glen, with an Opinion by Nicholas Underhill, another English barrister (Exh. C).

(Dkt. #99).[5]/ On June 30, 1993, these motions were referred to this Magistrate Judge (Dkt. #95).

For the reasons stated below, defendants' motions are granted.

## I. FACTUAL BACKGROUND[6]/

The jurisdictional facts are as follows:

As previously indicated, Itoba, a corporation organized under the laws of the States of Jersey, Channel Islands, is a wholly-owned subsidiary of ADT, a Bermudian corporation. ADT's primary business is providing electronic security services and alarm systems for residential and commercial property, and conducts an extensive security services business in the United States through its wholly-owned subsidiary, ADT Security Systems, a Delaware corporation (Hammond Aff't ¶¶3-4). ADT maintains executive offices in the United States, its stock is traded on the New York Stock Exchange, and approximately fifty percent (50%) of its shares are held in the United States (id. ¶6). Itoba is one of ADT's approximately twenty subsidiaries whose principal business is to hold investments for ADT (id. ¶¶7-9; Crespel Dep. Tr. at 59).

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5/ Four additional exhibits were attached: additional excerpts from the East deposition (Exh. 1); additional excerpts from the Percival deposition (Exh. 2); additional excerpts from the Read deposition (Exh. 3); and an opinion letter from Samuel Stamler and Ian Glick, two more British barristers (Exh. 4).

The filings associated with these motions are nearly six inches thick.

6/ See note 8 infra.

As previously indicated, LEP is a British corporation. "Ordinary Shares" of LEP's stock are traded on the London Stock Exchange; however since September 30, 1988, LEP's American Depository Shares ["ADS"] are traded on the National Association of Securities Dealers Automatic Quotation System ["NASDAQ"]; each ADS is evidenced by an American Depository Receipt ["ADR"], which represents five Ordinary Shares (Crespel Dep. Tr. at 100; Percival Dep. Tr. at 29, 61-62; Berkley Dep. Tr. at 54; Dkt. #87, Exh. 4, at 12-13; Dkt. #94, Exh. 2, at 14-16). It is in connection with the ADS's and ADR's that LEP has made its filings with the SEC (see, e.g., Dkt. #87, Exhs. 1-4; Dkt. #91, Exh. 3; Dkt. #94, Exh. 2). At issue in this litigation are LEP's filings, commencing in July 1989, of Form 6-K's and 29-F, which allegedly failed to disclose significant financial problems; various items were attached to such forms, including LEP's 1988 and 1989 Annual Reports, as well as a press release bearing the dateline, "Greenwich, Connecticut."

In spring 1990, ADT "recommended" to Itoba that the subsidiary purchase LEP stock (Hammond Aff't ¶14; Wells Aff't ¶¶12-14; Hammond Dep. Tr. at 59-60, 70-71, 106-07, 215; Crespel Dep. Tr. at 66-68, 85-86).[7]/ In reaching this "recommendation," ADT had relied upon a report prepared

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7/ ADT contends that it is common practice for a parent corporation to acquire securities through a wholly-owned subsidiary, which practice avoids early identification of the parent and minimizes disturbances in the market which might affect the stock's trading price (Hammond Aff't ¶13). However, ADT also conceded, at depositions, that the transaction would have been subject to U.K. taxation if the decision to purchase the stock had been made in England (Hammond Dep. Tr. at 215-16; Crespel Dep. Tr. at 25-26, 60, 66).

by an investment bank; this bank, in turn, had reviewed LEP's recent U.K. annual reports and circular to shareholders and its Form 20-F filed with the SEC (Wells Aff't ¶¶5-11, 14; Exh. 1). Executives at ADT, however, did not themselves review the SEC filings (Crespel Dep. Tr. at 74), nor did any executives at Itoba (id. at 68). Between June 4, 1990 and November 23, 1990, Itoba acquired 37,267,830 shares of LEP stock as they became available on the London stock market, for an aggregate price of approximately $114 million (Hammond Aff't ¶21). These shares were purchased through Shearson Lehman's London office, which in turn dealt with other stock brokerage firms, including two located in New York City (Hammond Aff't ¶¶9, 17-18; Hammond Dep. Tr. at 162-68, 218-20; Berkley Dep. Tr. at 54-68).

In September 1991, LEP first disclosed that it was facing financial problems; LEP ultimately wrote off $522 million in losses for that year (Hammond Aff't ¶20; Wells Aff't ¶16). As a result, the value of Itoba's shares fell to approximately $2.26 million, resulting in a loss of $111 million (Hammond Aff't ¶21).

## II. DISCUSSION

Defendants filed this motion to dismiss pursuant to Rule 12(b)(1) of the Federal Rules of Civil Procedure, challenging this court's subject matter jurisdiction over this cause of action.[8]/

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8/ A threshold matter to be resolved is the appropriate standard of review. There is no dispute that once a party challenges the district court's subject matter jurisdiction, the burden of establishing such jurisdiction rests on the party asserting jurisdiction. Wills v. Ferrandino, 830 F. Supp. 116, 122 (D. Conn. (continued...)

8(...continued)

1993); Washton v. U.S., 2:91 CV 121(AHN), 1993 U.S. Dist. LEXIS 2863, at *6 n.1 (D. Conn. Feb. 12, 1993); Travelers Indemnity Co. v. Household International, Inc., 775 F. Supp. 518, 522 (D. Conn. 1991). Thus, plaintiff here bears the burden of establishing the court's jurisdiction.

There is similarly no dispute that in deciding a Rule 12(b)(1) motion challenging the district court's jurisdiction, the court may look beyond the complaint and rely on extra pleading materials. Hicks v. Brophy, 3:93 CV 1595 (JAC), 1993 U.S. Dist. LEXIS 18495, at *5 (D. Conn. Dec. 14, 1993); Wills, supra, 830 F. Supp. at 122; Ensign-Bickford Co. v. ICI Explosives USA Inc., 817 F. Supp. 1018, 1023 (D. Conn. 1993); Washton, supra, 1993 U.S. Dist. LEXIS 2863, at *6 n.1. The parties disagree as to how a court should respond to conflicting affidavits, depositions, and documents. Under such circumstances, courts have looked to the decisions which have developed the standards for summary judgment under Rule 56 to "assist in resolving the problem encountered if the affidavits submitted on a 12(b) (1) motion should reveal the existence of factual problems." Exchange National Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126, 1130-31 (2d Cir. 1976); cf. Washton, supra, 1993 U.S. Dist. LEXIS, at *6 n.1.

Looking to Rule 56 summary judgment standards, the court will resolve all factual "ambiguities and inferences" in the light most favorable to the party opposing the motion, in this case, plaintiff Itoba. Matsushita Electric Industrial Co., Ltd. v. Zenith

(continued...)

## A. SUBJECT MATTER JURISDICTION

Both the Securities Act of 1933 and the Securities and Exchange Act of 1934 are silent as to their extraterritorial application, so that the federal courts have had to determine "whether Congress would have wished the previous resources of the United States courts" to be used in resolving disputes between foreign entities in the area of securities fraud. Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 985 (2d Cir.), cert. denied sub nom. Bersch v. Arthur Andersen & Co., 423 U.S. 1018 (1975). To determine whether the district courts have subject matter jurisdiction over these foreign transactions, the Second Circuit has fashioned two principal tests: the "effects test" and the "conduct test." Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir.), cert. denied, 112 S. Ct. 638 (1991). Only one of the two tests must be satisfied in order for subject matter jurisdiction to be conferred on the district court in a securities fraud action. Psimenos v. E.F. Hutton & Co., Inc., 722 F.2d 1041, 1045 (2d Cir. 1983).

### 1. "CONDUCT TEST"

In Alfadda, supra, the Second Circuit's described the "conduct test" as follows: "a federal court has subject matter jurisdiction if the defendant's conduct in the United

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8(...continued)

Radio Corp., 475 U.S. 574, 587 (1986); Delaware & Hudson RY. Co. v. Consolidated Rail Corp., 902 F.2d 174, 177 (2d Cir. 1990), cert. denied, 111 S.Ct. 2041 (1991). Thus, for the purposes of considering defendants' motions to dismiss, the facts will be viewed in the light most favorable to plaintiff Leasco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326, 1330 (2d Cir. 1972).

States was more than merely preparatory to the fraud, and particular acts or culpable failures to act within the United States directly caused losses to foreign investors abroad." 935 F.2d at 478 (citations omitted).

This test has been applied with varying results. For example, in one of the earliest cases, Leasco Data Processing Equipment Corn. v. Maxwell, 468 F.2d 1326, 1336-37 (2d Cir. 1972), the action was commenced by American citizens against (the now late) Robert Maxwell, a British citizen, with respect to a British company's stock, traded solely on the London Stock Exchange; subject matter jurisdiction was found because "substantial misrepresentations were made in the United States." The same conclusion more recently was reached in Alfadda, supra, 935 F.2d at 478-79, where the plaintiffs were all residents of Saudi Arabia or Bahrain, and the corporate defendants were either Netherlands Antilles or French companies. However, jurisdiction in this country was appropriate in that the allegedly fraudulent activity, i.e., negotiations and communications which diluted plaintiffs' shares, all took place in the United States. See also Psimenos, supra, 722 F.2d at 1045-48 (subject matter jurisdiction found in action brought by Greek citizen regarding purchases made through defendant's Athens and Paris offices, where plaintiff was induced by pamphlets prepared in the U.S. and where transactions were consummated in New York).

The plaintiff-class in Bersch, supra, were thousands of shareholders, who primarily were citizens of Canada, Australia, England, France, Germany, Switzerland and of several other European, Asian, African, and South American countries, with some Americans. The action involved the stock of a Canadian company, which had its main business office in Switzerland; the underwriters included two large American banking houses -- Drexel Firestone, Inc. and Smith, Barney & Co -- and four foreign

underwriting houses. The prospectuses, which were printed abroad in English, French and German, and which were delivered to purchasers outside the United States, specifically provided that these shares of stock were not being offered in the U.S. In applying the "conduct test," the Second Circuit differentiated between three sets of plaintiffs:

(1) American residents, who could commence securities actions here, without regard to whether the alleged acts of material importance occurred in this country; (2) American residents abroad, who were permitted to commence securities actions here "if, but only if, [alleged] acts . . . of material importance in the United States have significantly contributed (to their losses]"; and (3) foreigners, who could commence such actions here only if the "[alleged] acts . . . within the United States directly caused (their financial losses]." 519 F.2d at 993.

There is no doubt that the factual circumstances here present a closer picture than those presented in the abovereferenced Second Circuit decisions. However, it would appear that plaintiff cannot prevail under the "conduct test" under the facts of this case. It is beyond dispute that SEC filings and press releases are the type of information on which an investor relies in making his or her investment decisions. Securities & Exchange Comm'n v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d cir. 1968), cert. denied sub nom. Coates v. Securities & Exchange Comm'n, 394 U.S. 976 (1969) Even beyond the issue of whether the SEC filings were "merely preparatory to the fraud," plaintiff cannot demonstrate that the alleged acts within the United States "directly caused [its] losses" for two reasons. First, Itoba and ADT did not read the SEC filings or rely upon them; it was an investment bank hired by ADT which had reviewed these document. And second, the SEC filings were filed in connection with LEP's ADS's and ADR'S, not the Ordinary Shares purchased by Itoba, for

which annual reports and press releases were generated from England.

This conclusion is consistent with two recent district court opinions, Koal Industries Corn. v. Asland, S.A., 808 F. Supp. 1143, 1153-55 (S.D.N.Y. 1992) and Nathan Gordon Trust v. Northgate Exploration, Ltd., 148 F.R.D. 105, 107-08 (S.D.N.Y. 1993). In Koal Industries, the plaintiffs, a Panamanian corporation and nationals, acquired from companies organized in Netherlands Antilles an interest in a mining company located in Arkansas. The negotiations, the drafting of the purchase agreement, and its execution all took place in Switzerland; the financing was obtained from outside the United States. The only contact with the United States, other than the location of the mine, was a single telephone call seeking additional funding; the district court characterized that single telephone call as "at best, a preparatory act," so that subject matter jurisdiction was lacking. The underlying facts in Nathan Gordon Trust are even closer to this case. The defendant was a Canadian corporation whose stock was traded on the New York, Toronto, Montreal, and London Stock Exchanges; the alleged misrepresentations were authored entirely in Canada, although they were attached to documentation filed with the SEC here and to some extent circulated in this country. Relying upon Alfadda, supra, the district court limited the class action to transactions made on the New York Stock Exchange only:

> The court rules that the relevant "conduct" in the present case occurred in Canada where the alleged misleading information was authored. The mere filing of reports with the SEC and the dissemination of some materials to shareholders in the United States were merely incidental to the authorship, preparation and dissemination of the allegedly false information, all of which

> occurred in Canada. Accordingly, the court does not have subject matter jurisdiction over the claims arising from transactions on foreign exchanges.

148 F.R.D. at 108.

2. EFFECTS TEST"

The second test to be applied is the "effects test," which applies "where illegal activity abroad causes a "substantial effect' within the United States." Alfadda, supra, 935 F.2d at 478 (citation omitted). As the Second Circuit observed in Bersch, supra, this test is not met "simply because in the long run there was an adverse effect on this country's general economic interests or on American security prices," or when the alleged acts "simply have an adverse [e]ffect on the American economy or American investors generally. 519 F.2d at 989 (footnotes omitted).

Subject matter jurisdiction was found under the "effects test" in Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 262-63 (2d Cir. 1989). The plaintiff there was a British corporation, with numerous American subsidiaries; half of its $2.4 billion in assets were located in this country. Defendant was a Luxembourg corporation, largely controlled by South African companies and individuals. The Second Circuit found that the "effects test" had been satisfied, because 2.5% of plaintiff's shareholders were American, holding approximately 5.3 million shares with a market value of approximately $120 million.

In contrast, no subject matter jurisdiction was found in Koal Industries, supra, where the plaintiff was not an American investor, the defendants' stock was neither registered nor listed on a national securities exchange, and

the only financial damage was the demise of the Arkansas mine.

If the court were to focus solely upon Itoba, the only named plaintiff, it is clear that the "effects test" would not be satisfied. It is equally clear that if ADT were the plaintiff, the "effects test" would be met, in that ADT's stock is traded on the New York Stock Exchange and approximately fifty percent (50%) of its shares are held in this country.

Itoba argues that ADT's attributes ought to be considered here, under the rationale of Leasco, supra. In that case, the named plaintiff was Leasco Data Processing Equipment Corporation ["Leasco"], an American corporation, which had negotiated to purchase more than five million shares in Maxwell's company, Pergamon Press Limited, a British company; such stock had been purchased with cash provided by its wholly-owned subsidiary, Leasco International N.V. ["Leasco N.V."], a Netherlands Antilles corporation, and Leasco had unconditionally guaranteed Leasco N.V.'s financial obligations. 468 F.2d at 1332-33. Leasco also sent a letter to the British company indicating that Leasco "has an interest" in the shares of stock, and that such shares "are held on behalf of Leasco . . . N.V." Id. at 1338. Among defendants' arguments to defeat subject matter jurisdiction was that the "purchaser" of the stock was not an American company but a Netherlands Antilles corporation. The Second Circuit disagreed:

> It seems quite arguable from all this that Leasco N.V. is holding the shares merely as trustee for Leasco, which has the beneficial interest and is bound to reimburse Leasco N.V. for the latter's expenditures. If that were so, defendants, contention that the true purchaser was a foreigner would be drained of force. But even if Leasco N.V. is the beneficial owner, it would be ele-

> vating form over substance to hold that this entails a conclusion that the purchases did not have a sufficient effect in the United States to make § 10(b) apply. Whether Leasco N.V. is merely a financial conduit, as plaintiffs assert, or was planned to conduct an active business, as some of the SEC filings indicate, it was wholly-owned and its debt securities were guaranteed by Leasco and were convertible with Leasco common stock. We see no need to enter into the debate whether, as defendants contend and plaintiffs deny, Leasco obtained substantial tax and other advantages through the incorporation of Leasco N.V. and the use of the latter to acquire the Pergamon shares.

Id. at 1338.

The Leasco case is distinguishable for at least three reasons. First, and most obvious, is the simple fact that the named plaintiff in Leasco was Leasco, an American corporation, and not its foreign subsidiary. Second, despite the copious filings made by both sides, no evidence was submitted here that ADT made any unconditional guaranties of Itoba's obligations. And third, the written contract between Leasco and Pergamon expressly provided that "at (Leasco's) election," the offer to purchase could be made "by a wholly-owned subsidiary of Leasco or a wholly-owned subsidiary of such subsidiary"' and that Leasco "shall remain responsible for the due performance" of the obligation to acquire the shares. The Second Circuit thus concluded: "In acceding to this provision the defendants themselves recognized that Leasco, the United States company, remained at all times intimately involved in the transaction; the foreign entity was accepted by both sides as the alter ego of the American." Id. at 1338. In the present action, there were no similar negotiations between

Itoba/ADT and LEP, so that LEP could be deemed to have viewed Itoba and ADT as being interchangeable.

In light of these distinguishing factors, this court is not willing to disregard corporate formalities and treat Itoba and ADT as functional equivalents.

## B. FORUM NON CONVENIENS

Given the conclusion reached in Section II.A. supra, there is no need to address the issue of forum non conveniens.

## III. CONCLUSION

For the reasons stated above, defendants' motions to dismiss (Dkt. ##83, 86, & 87) are granted.

See 28 U.S.C. § 636(b)(written objections to ruling must be filed within ten days after service of same); F.R. Civ.P. 6(a), 6(e) & 72; Rule 2 of the Local Rules for United States Magistrate Judges, United States District Court for the District of Connecticut; Small v. Secretary, H&HS, 892 F.2d 15, 16 (2d Cir. 1989) (failure to file timely objection to Magistrate Judge's recommended ruling may preclude further appeal to Second Circuit).

Dated at New Haven, Connecticut, this 4th day of February, 1994.

Joan Glazer Margolis
U.S. Magistrate Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

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| ITOBA LIMITED | : | 5:92CV00556(WWE) |
| V. | : | |
| LEP GROUP plc, ET AL | : | DATE:FEBRUARY 4, 1994 |

3/14/94: After de novo review, and over objection, the ruling of the Magistrate Judge is hereby AFFIRMED.

Warren W. Eginton
Senior U.S. District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF CONNECTICUT

| | | |
|---|---|---|
| ITOBA LIMITED | : | 5:92CV00556(WWE) |
| V. | : | |
| LEP GROUP plc, ET AL | : | DATE:FEBRUARY 4, 1994 |

Corrected
JUDGMENT

This cause came on for consideration on plaintiff's motion for order pursuant to Rule 60(a) or, in the alternative pursuant to Rule 54 (b) before the Honorable Warren W. Eginton, Senior United States District Judge, and

The Court having considered the motion and all the papers submitted in connection therewith granted the motion and further ordered judgment to enter in favor of defendant John L. Read in addition to those defendants in whose favor judgment has already entered, Fed. R. Civ. P. 60(a),

It is therefore ORDERED and ADJUDGED that the judgment be and hereby is entered in favor of the defendants Lep Group, John East, Peter Grant, William Berkley, and John L. Read, in accordance with the court's order.

Dated at Bridgeport, Connecticut this 23rd day of May, 1994.

KEVIN F. ROWE, Clerk

By _____
Carol E. Cannady
Deputy in Charge

**ITOBA LIMITED, Plaintiff-Appellant**

**v.**

**LEP GROUP PLC, William R. Berkley, John L. Read, Peter J. Grant, John R. East, Defendants-Appellees**

**No. 582, Docket 94-7562**

**United States Court of Appeals, Second Circuit**

**Argued Dec. 1, 1994**

**Decided May 15, 1995**

Wholly owned subsidiary of United States corporation, based in Bermuda, brought suit against British issuer and its United States-based officers, alleging stock fraud. The United States District Court for the District of Connecticut, Warren H. Eginton, J., adopted magistrate judge's recommendations and dismissed suit. Appeal was taken. The Court of Appeals, Van Graafeiland, Circuit Judge, held that material issues of fact, precluding summary judgment, existed as to whether British issuer had committed securities fraud by making false and misleading statements in Securities and Exchange Commission Form 20-F reports filed in connection with the deposit of some of its shares with American depository and United States trading in related American Depository Shares on United States markets.

Reversed and remanded.

Mark C. Zauderer, New York City (James Robert Pigott, Jr., Stein, Zauderer, Ellenhorn, Frischer & Sharp, New York City, Richard F. Lawler, James C. Riley,

Whitman Breed Abbott & Morgan, Greenwich, CT, of counsel), for plaintiff-appellant.

Jeffrey E. Glen, New York City (Berwin Leighton, New York City, Mark B. Seiger, Halloran & Sage, Hartford, CT, of counsel), for defendant-appellee LEP Group PLC.

William McGuinness, New York City (Fried, Frank, Harris, Shriver & Jacobson, New York City, of counsel), for defendants-appellees William R. Berkley and Peter J. Grant.

Alan H. McLean, Stamford, CT (Neville, Shaver, Kelly & McLean, Stamford, CT, of counsel), for defendant-appellee John R. East.

John L. Read, pro se.

Before: FEINBERG, VAN GRAAFEILAND and MINER, Circuit Judges.

VAN GRAAFEILAND, Circuit Judge:

Itoba Limited appeals from a judgment of the United States District Court for the District of Connecticut (Eginton, J.) dismissing its securities fraud action against Lep Group PLC, William Berkley, John Read, Peter Grant and John East for lack of subject matter jurisdiction. For the reasons stated below, we reverse and remand for further proceedings.

The corporate defendant in this case, Lep Group PLC, is a London-based holding company with some fifty subsidiaries operating in thirty countries. It is a true conglomerate, owning businesses in freight forwarding, home security systems, biotechnology, travel services, and real estate speculation. Lep's "ordinary shares", the British equivalent of common stock, are registered in the United Kingdom, obligating the company to comply with United Kingdom securities laws. The primary trading market for Lep's ordinary shares is the International Stock Exchange of

the United Kingdom and the Republic of Ireland Ltd. (the "London Exchange").

To create a United States market for its ordinary shares, Lep deposited 12,842,850 of its approximately 136 million shares in an American depository in 1988. The depository in turn issued an American Depository Receipt (ADR) for each five ordinary shares of Lep on deposit. Because these ADRs trade in the form of American Depository Shares (ADSs) on the National Association of Securities Dealers Automated Quotation System ("NASDAQ"), Lep is subject to the reporting and disclosure requirements of United States securities law.

A.D.T. Limited ("ADT") is a transnational holding company based in Bermuda. Its shares are listed on the New York Stock Exchange and approximately fifty percent of its shareholders of record reside in the United States. Itoba, a Channel Islands company, is a wholly-owned subsidiary of ADT. ADT also is the corporate parent of A.D.T. Securities Systems, Inc., a Delaware-based firm and one of America's largest suppliers of security and protection services.

In mulling over expansion plans for A.D.T. Securities Systems, ADT considered the possible acquisition of one of A.D.T. Securities Systems' largest competitors in the American security market, National Guardian, ADT already owned a small interest in that corporation through shares it held of Lep, the parent company of National Guardian. Because ownership of Lep would lead to control of National Guardian, ADT considered increasing its Lep holdings.

At the same time, Canadian Pacific was interested in expanding into the freight forwarding business and also was pondering a sizeable investment in Lep. Learning of their mutual interest, the companies agreed to explore a joint purchase of Lep. Canadian Pacific hired S.G. Warburg, a London investment bank, to evaluate Lep's business

operations. Nicholas Wells, ADT's in-house financial analyst, was directed by Michael Ashcroft, ADT's chairman, to perform a valuation of Lep.

In December 1989, S.G. Warburg issued an extensive report assessing Lep's prospects. The analysis in this report was based on Lep's U.K. annual reports, the Form 20-F that Lep filed with the United States Securities and Exchange Commission for the year ended December 31, 1988, Lep's shareholder register, and broker reports. Shortly after the Warburg report was issued, Canadian Pacific abandoned the proposed joint venture.

ADT's interest, on the other hand, did not diminish. Wells continued his examination of Lep, relying heavily on the Warburg report. To supplement his research, he obtained from Canadian Pacific a copy of Lep's Form 20-F for 1988. Wells frequently discussed his analyses of these documents with David Hammond, ADT's vice chairman and the person in charge of acquisitions.

Based on Wells' analyses and their own review of the Warburg report, Hammond and Ashcroft decided to acquire Lep. Soon thereafter, Hammond formulated a plan to increase ADT's Lep holdings by making anonymous purchases on the market through one of ADT's offshore companies, in this case Itoba. Hammond contacted the board members of Itoba and recommended that they approve his purchase plan.

As expected, Itoba's board approved the plan. Itoba's board then requested one of ADT's employees to commence share purchases in Itoba's name; these purchases were made according to Hammond's plan and paid for by ADT. During the second half of 1990, Itoba executed a number of significant purchases on the London Exchange pursuant to the plan. By November 1990, Itoba had acquired over 37 million Lep ordinary shares for approximately $114 million.

Before ADT could complete its planned acquisition, however, Lep disclosed a series of business reversals that

decimated its share value; Lep's stock price plummeted 97% and the value of Itoba's Lep holdings declined by nearly $111 million. Lep wrote off approximately $522 million from its books for the fiscal year ended December 31, 1991.

Itoba sued Lep and its officers in the District of Connecticut, asserting violations of sections 10(b) and 20 of the Securities Exchange Act of 1934 (the "Act") and of Rule 10b-5. According to Itoba, the defendants were subject to liability because they failed to disclose material matters in statements filed with the SEC. Specifically, Itoba alleged that Lep made high risk investments and engaged in speculative business ventures without informing the investing public. Itoba claimed that had these matters been properly disclosed, it would not have purchased Lep's stock at artificially inflated prices.

Itoba also asserted claims against Lep director William Berkley for alleged violations of sections 10(b) and 12(2) of the Act and of Rule 10b-5. Berkley, a United States citizen and a resident of Connecticut, had sold a large block of Lep ordinary shares in the United States on the same day that Itoba purchased a large block of shares in London. Itoba alleged that had Berkley properly complied with his duty to disclose material, nonpublic information before trading, it would not have made that purchase.

Defendants moved to dismiss Itoba's claims for lack of subject matter jurisdiction, and Magistrate Judge Jean Margolis, to whom the matter was referred for recommendation and report, issued a report that recommended dismissing Itoba's action on jurisdictional grounds. The district court adopted the magistrate judge's recommendations in toto. It dismissed Itoba's action on Fed.R.Civ.P. 12(b)(1) grounds in a short-form order. This, we conclude, was error.

It is well recognized that the Securities Exchange Act is silent as to its extraterritorial application. See, e.g.,

Alfadda v. Fenn, 935 F.2d 475, 478 (2d Cir.) (citing 15 U.S.C. s 78aa), cert. denied, 502 U.S. 1005, 112 S.Ct. 638, 116 L.Ed.2d 656 (1991). However, in determining whether Congress intended that the "precious resources of United States courts" be devoted to a specific transnational securities fraud claim, we are not without guidance. Two jurisdictional tests have emerged under this Court's decisions: the "conduct test", as announced in Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1336-37 (2d Cir.1972), and the "effects test", as announced in Schoenbaum v. Firstbrook, 405 F.2d 200, 206-09 (2d Cir.), rev'd with respect to holding on merits, 405 F.2d 215 (2d Cir.1968) (in banc), cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906, 89 S.Ct. 1747, 23 L.Ed.2d 219 (1969). There is no requirement that these two tests be applied separately and distinctly from each other. Indeed, an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court. It is in this manner that we address the issue of jurisdiction in the instant case. Because we believe that the allegations are sufficient to support jurisdiction, we reverse.

Under the conduct test, a federal court has subject matter jurisdiction if (1) the defendant's activities in the United States were more than "merely preparatory" to a securities fraud conducted elsewhere, Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir.), cert. denied, 423 U.S. 1018, 96 S.Ct. 453, 46 L.Ed.2d 389 (1975), and (2) these activities or culpable failures to act within the United States "directly caused" the claimed losses, Alfadda, supra, 935 F.2d at 478. Inherent in the conduct test is the principle that Congress does not want " 'the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.' " Psimenos v. E.F. Hutton & Co., 722 F.2d

1041, 1045 (2d Cir.1983) (quoting IIT v. Vencap, Ltd., 519 F.2d 1001, 1017 (2d Cir.1975)).

The magistrate judge correctly stated the conduct test when she said that Itoba must prove that Lep's United States-based activities directly caused Itoba's financial losses. However, whether she correctly applied the test is an entirely different matter. The magistrate judge based her recommendation to deny jurisdiction on the following findings: First, Itoba and ADT did not read the SEC filing and rely on them; it was an investment bank hired by ADT which had reviewed the documents. And second, the SEC filings were filed in connection with LEP's ADS's and ADR's, not the ordinary shares purchased by Itoba, for which annual reports and press releases were generated from England.

The magistrate judge's first finding--that ADT and Itoba did not read and rely on the SEC filing in making their purchase decision--must be rejected in view of the clearly-established fact that the executives of Itoba and ADT based their investment decision on the Warburg report. The analyses and conclusions in this report were predicated on information found in the Form 20-F that Lep filed with the SEC. Nicholas Wells, the ADT executive responsible for assessing investment prospects, made the Warburg report the centerpiece of his Lep valuation. Moreover, he not only relied on the discussion of the SEC filing as contained in the Warburg report, he also used his own copy of the 1988 Form 20-F to formulate his purchase recommendations. According to the affidavit of ADT's vice chairman, the decision to acquire Lep was based upon these recommendations.

The fact that Itoba's board members did not read the SEC filing is not of controlling significance. A party need not personally have read a misleading financial report to establish reliance; derivative reliance is a well-established basis for liability in a Rule 10b-5 action. See, e.g., Austin

v. Loftsgaarden, 675 F.2d 168, 177-78 & n. 19 (8th Cir.1982), appeal after remand, 768 F.2d 949 (8th Cir.1985), rev'd on other grounds sub nom. Randall v. Loftsgaarden, 478 U.S. 647, 106 S.Ct. 3143, 92 L.Ed.2d 525 (1986); Garfinkel v. Memory Metals, Inc., 695 F.Supp. 1397, 1404 (D.Conn.1988); Kronfeld v. Trans World Airlines, Inc., 104 F.R.D. 50, 53- 54 (S.D.N.Y.1984); Walsh v. Butcher & Sherrerd, 452 F.Supp. 80, 84 (E.D.Pa.1978); In re Ramada Inns Sec. Litig., 550 F.Supp. 1127, 1131 (D. Del. 1982). The acquisition plan that Itoba's directors approved was formulated and funded by ADT, which in turn relied on its financial officer's analysis of the Warburg report and Lep's SEC filing. The contents of Lep's 1988 Form 20-F were thus a "substantial" and "significant contributing cause" to Itoba's purchase decision. There is no requirement, as suggested by the magistrate judge's decision, that Itoba read Lep's filing before it could rely on it.

The magistrate judge's second reason for denying jurisdiction, i.e., that the SEC filings were made in connection with Lep's ADSs and ADRs, not its ordinary shares, is only fifty percent correct and therefore is one hundred percent wrong. The ADRs were simply a grouping into one security of five ordinary shares. Inevitably, there was a direct linkage between the prices of the ADRs representing five ordinary shares and the prices of the single ordinary shares themselves. If the ordinary share price fell on the London Exchange, the market price of an ADR would decrease in similar manner, and visa versa.

Finally, a Rule 10b-5 action is not barred because a false and misleading statement in an SEC filing pertains to a security that is not the security purchased. See In re Ames Dep't Stores Inc. Stock Litig., 991 F.2d 953, 961-62 (2d Cir.1993). So long as the fraudulent device employed is of the type that would cause reasonable investors to rely thereon and, so relying, cause them to purchase or sell the

corporation's securities, a Rule 10b-5 action may lie. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir.1968) (in banc), cert. denied sub nom. Coates v. Securities & Exchange Comm'n, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969). SEC filings generally are the type of "devices" that a reasonable investor would rely on in purchasing securities of the filing corporation. When these United States filings include substantial misrepresentations, they may be a predicate for subject matter jurisdiction. See Psimenos, supra, 722 F.2d at 1045 (citing Leasco, supra, 468 F.2d at 1337).

The fact that the Lep ordinary shares were issued and purchased in England does not change our conclusion. "The conduct test does not center its inquiry on whether domestic investors or markets are affected, but on the nature of conduct within the United States as it relates to carrying out the alleged fraudulent scheme...." Psimenos, supra, 722 F.2d at 1045; see Leasco, supra, 468 F.2d at 1337.

Moreover, the making of the allegedly false and misleading filings with the SEC was not "merely preparatory to the fraud." Although the magistrate judge refrained from forthrightly stating as much, she tiptoed around that statement as follows: It is beyond dispute that SEC filings and press releases are the type of information on which an investor relies in making his or her investment decisions. Securities & Exchange Comm'n v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir.1968), cert. denied sub nom. Coates v. Securities & Exchange Comm'n, 394 U.S. 976[, 89 S.Ct. 1454, 22 L.Ed.2d 756] (1969). Even beyond the issue of whether the SEC filings were "merely preparatory to the fraud," plaintiff cannot demonstrate that the alleged acts within the United States "directly caused [its] losses" for two reasons. She then propounded the two reasons we have rejected in the preceding paragraphs and cited two cases whose application here is questionable at best, Koal Industries Corp. v. Asland, S.A., 808 F.Supp.

1143, 1153-55 (S.D.N.Y.1992) and Nathan Gordon Trust v. Northgate Exploration, Ltd., 148 F.R.D. 105, 107-08 (S.D.N.Y. 1993). In Koal Industries, a Panamanian corporation acquired two Netherlands Antilles corporations which owned interests in an Arkansas mining company. The entire transaction took place in Switzerland and the financing was obtained from outside the United States. The only contact with the United States other than the location of the mine was a telephone call seeking additional funds for the acquisition. Northgate involved a motion for class certification. The defendant was a Canadian corporation which owned an interest in a gold mine located in northern Canada, concerning which the defendant filed allegedly false SEC statements. The proposed class was to consist of all persons who purchased Northgate stock on the Toronto, Montreal, London and New York Exchanges. The defendant requested that the class be limited to those who purchased on the New York Exchange, and the district court granted its request. In contrast to the discretionary nature of the district court's class certification ruling and the "fraud on the market" class issues of Northgate, the instant case involves a single plaintiff asserting direct individual fraud.

Appellees address the issue of "preparatory conduct" more directly. They assert that the mere filing of a document with the SEC should not trigger jurisdiction in United States courts. In support of this contention, they point out that Lep's financial statements were prepared in England and contend that the act of filing alone should not confer subject matter jurisdiction in the United States. They say further that the filing was "incidental or preparatory conduct" in whatever wrongdoing may have occurred. With respect to the first contention, we hold that the situs of preparations for SEC filings should not be determinative of jurisdictional questions. Otherwise, the protection afforded by the Securities Exchange Act could be circumvented simply by preparing SEC filings outside the

United States. We find no support in the Act for such a result.

The second half of appellees' argument overlooks a basic purpose of the securities law, which is fair disclosure of material facts. A material fact that is undisclosed in an SEC filing remains undisclosed absent public enlightenment. This may bring into play a concomitant duty, i.e., the duty to correct. See 2 Bromberg & Lowenfels, Securities Fraud & Commodities Fraud s 6.11, at 138.401-.509 (2d ed. 1994). Lep's uncorrected nondisclosure played as much a role in Itoba's purchases as the price listings on the London Exchange and NASDAQ. In view of the deleterious effect this continued nondisclosure had on the thousands of ADT shareholders in the United States, it cannot be described correctly as incidental or preparatory.

This argument, of course, combines pertinent principles of both the conduct and effects tests, the latter one being based on fraud which takes place abroad which impacts on "stock registered and listed on [an American] national securities exchange and [is] detrimental to the interests of American investors." Schoenbaum, supra, 405 F.2d at 208. Here, we have fraud occurring on an American exchange and persisting abroad that has impacted detrimentally upon thousands of United States shareholders in the defrauded company, i.e., over $100 million lost in the shareholders' corporate equity.

The magistrate judge held that "if ADT were the plaintiff, the 'effects test' would be met, in that ADT's stock is traded on the New York Stock Exchange and approximately fifty percent (50%) of its shares are held in this country." See generally Consolidated Gold Fields PLC v. Minorco, S.A., 871 F.2d 252, 262-63 (2d Cir.), amended on other grounds, 890 F.2d 569 (2d Cir.), cert. dismissed, 492 U.S. 939, 110 S.Ct. 29, 106 L.Ed.2d 639 (1989); Matter of Marc Rich & Co. A.G., 707 F.2d 663, 666-67 (2d

Cir.), cert. denied, 463 U.S. 1215, 103 S.Ct. 3555, 77 L.Ed.2d 1400 (1983); United States v. Aluminum Co. of Am., 148 F.2d 416, 443 (2d Cir.1945); Restatement (Second) of Law of Foreign Relations s 18(b), cmt. d. We believe this reasoning applies with equal effect where, although Itoba, ADT's wholly- owned subsidiary, was the nominal purchaser and owner of the Lep stock, it was ADT which financed the deal and which, with its shareholders, ultimately must bear the loss. This is not a case in which Lep's acts "simply [had] an adverse affect [sic] on the American economy or American investors generally." See Bersch, supra, 519 F.2d at 989. In short, we hold that a sufficient combination of ingredients of the conduct and effects tests is present in the instant case to justify the exercise of jurisdiction by the district court. See generally Leasco, supra, 468 F.2d at 1338.

For some reason that is not clear to us, the magistrate judge did not consider it necessary to address specifically Itoba's causes of action against any of the individual defendants. She simply recommended a blanket dismissal of the complaint as to all defendants, which recommendation was adopted without discussion by the district court. We find this particularly troublesome with respect to the defendant Berkley.

On October 8, 1990, Berkley, a United States resident and a Lep director, sold 7,300,000 ordinary shares of Lep to his United States-based broker, New York & Foreign Securities Corporation, which in turn sold these shares for its own account on the London Exchange. Berkley received almost $24 million for his shares. That same day, Itoba purchased 7,500,000 shares on the London Exchange through its London-based broker. Whether the close temporal relationship of these two transactions is or is not coincidental presents an interesting question. After executing this purchase, Itoba and ADT executives learned that the shares they had acquired were owned previously by

Berkley. When Itoba brought the instant action, it asserted a separate claim against Berkley based on this Court's "disclose or abstain" rule, which imposes on insiders a duty to disclose material information before trading in their company's securities. See SEC v. Texas Gulf Sulphur Co., supra, 401 F.2d at 848. In Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (2d Cir.1974), we held that an insider who fails to comply with his duty to disclose or abstain can be held liable "not only to the purchasers of the actual shares sold by [the insider,] but to all persons who during the same period purchased [the corporation's] stock in the open market without knowledge of the material inside information which was in the possession of [the insider]."

Although we do not presently rule on the issue, it would seem that Berkley's failure to disclose material, nonpublic information prior to selling his Lep shares is the type of behavior that falls under this Rule 10b-5 rubric. Because antifraud provisions are designed to prevent corporate insiders from taking unfair advantage of uninformed outsiders, Shapiro v. Merrill Lynch, supra, 495 F.2d at 235 (citing Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 890 (2d Cir.1972)), Berkley's alleged nondisclosure during a sales transaction executed by two parties within the United States--Berkley and his broker--is the type of conduct that should trigger jurisdiction. See Roth v. Fund of Funds, Ltd., 279 F.Supp. 935, 936-37 (S.D.N.Y.), aff'd, 405 F.2d 421 (2d Cir.1968), cert. denied, 394 U.S. 975, 89 S.Ct. 1469, 22 L.Ed.2d 754 (1969).

Moreover, it is not clear that Itoba is disabled from asserting its claim because it purchased its shares on a foreign market--the London Exchange. In Shapiro v. Merrill Lynch, supra, we held that an inside trader is subject to liability to all purchasers of his corporation's stock on the "open market." 495 F.2d at 237. Whether the

"open market" encompasses foreign exchanges is an issue we leave for remand.

We conclude that Itoba's claim against Berkley should not have been incorporated without discussion into Itoba's claim against the non-resident defendants and just as silently dismissed.

## CONCLUSION

Unlike some securities actions brought to recover questionable damages on behalf of optimistically described classes, we are met here with a single plaintiff which suffered direct substantial losses. A plaintiff such as this should not be deprived of its day in an American court by a Rule 12(b)(1) order based on erroneous facts and questionable law. We conclude that the issues now before us best can be resolved by a trial on the merits in which the facts relevant to jurisdiction may be more fully developed. See Bersch, supra, 519 F.2d at 992-93 (quoting Leasco, supra, 468 F.2d at 1330). We reverse the judgment below and remand for such a trial.

# 95-7562

## United States Court of Appeals

*for the*

## Second Circuit

---

ITOBA LIMITED
Plaintiff-Appellant

against

LEP GROUP PLC, WILLIAM R. BERKLEY,
JOHN L. READ,PETER J. GRANT,
JOHN R. EAST
Defendants-Appellees

---

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

---

7/14/95 Order FILED DENYING petition for REHEARING [674685-1] by Appellees Peter J. Grant, William R. Berkley, LEP Group PLC, endorsed on motion dated 5/30/95. DENYING petition for rehearing in banc [674685-2] by Appellees Peter J. Grant, William R. Berkley, LEP Group PLC, endorsed on motion dated 5/30/95. (BJM) (cv78)

**§ 78j. Manipulative and deceptive devices**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

**§ 78aa. Jurisdiction of offenses and suits**

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, and 1292 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court of such other courts.

**§ 240.10b-5. Employment of manipulation and deceptive devices**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Nos. 95-596, 95-606

Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1995

LEP GROUP PLC, WILLIAM R. BERKLEY, and PETER J. GRANT,

*Petitioners*,

—v.—

ITOBA LIMITED,

*Respondent.*

ON PETITIONS FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## RESPONDENT'S BRIEF IN OPPOSITION

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## STATEMENT PURSUANT TO RULE 29.6 OF THE RULES OF THE SUPREME COURT OF THE UNITED STATES

Respondent Itoba Limited ("Itoba") is the wholly-owned subsidiary of A.D.T. Limited, a Bermudan corporation the shares of which are listed on the New York Stock Exchange. Itoba has no nonwholly owned subsidiaries.

## JURISDICTION

Pursuant to Rule 24.2 of the Rules of this Court, respondent states that it is dissatisfied with the statement in the Petition filed by William A. Berkley and Peter J. Grant that "[t]he jurisdiction of the district court was invoked under 15 U.S.C. § 78c(17)." The Complaint alleges jurisdiction of the District Court under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa.

## COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Should the Court grant *certiorari* to review an interlocutory decision remanding the case to the District Court for further factual development of jurisdictional issues?

2. Should the Court grant *certiorari* when there is no conflict among the Circuits, which all apply a substantially similar Conduct Test/Effects Test analysis to determine subject matter jurisdiction over federal securities fraud claims?

3. Should the Court grant *certiorari* to review a decision that will not expand the territorial scope of the federal securities laws?

4. Should the Court grant *certiorari* to disturb twenty-five years of Circuit court decisions upholding the jurisdiction of the U.S. courts to regulate securities fraud in instances in

which fraudulent conduct either occurred in the United States or had substantial domestic effects?

## STATEMENT OF THE CASE

### A. Statement of Facts

The interlocutory order before the Court reinstated an action between two of the major competitors in the United States in the electronic security services business.[1] The action was commenced under the anti-fraud provisions of the federal securities laws to recover losses in excess of $100 million suffered by a single investor, A.D.T. Limited ("ADT"), arising from its investment, through its wholly-owned subsidiary, Itoba Limited ("Itoba"), in petitioner LEP Group plc ("LEP"). (A7)[2]

ADT, Itoba's parent, engages primarily in the businesses of providing security services (*i.e.*, residential and commercial property alarm systems) and conducting motor vehicle auctions in the United States and elsewhere. ADT's net sales in these two areas exceeded $1.2 billion for the year ended December 31, 1992. (JA438) ADT has thousands of shareholders, both record and beneficial owners, in the United States; as of May 1992, approximately 50 percent of ADT's common shares were held of record in the United States by

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[1] The facts set forth were current as of the date of the perfection of respondent's appeal to the Second Circuit in July, 1994. The material facts giving rise to the claims have not changed. We note that, within the past two months, petitioner LEP Group plc's security service subsidiary in the United States, National Guardian Corporation, has been sold.

[2] All references herein to "A__" are to pages of the Appendix to the Petition for a Writ of Certiorari filed by petitioners William R. Berkley and Peter J. Grant (hereinafter the "Berkley Pet."). All references herein to the "LEP Pet." refer to the Petition for Writ of Certiorari with Attached Appendix filed by petitioner LEP Group plc. All references to "JA___" are to pages of the Joint Appendix filed on the appeal before the Second Circuit.

over 2,000 record holders. (JA439) ADT's stock trades on the New York Stock Exchange. (JA439)

ADT has executive offices, which supervise its substantial North American operations, in Boca Raton, Florida, where its Chairman and its Chief Financial Officer maintain offices. (JA439) ADT conducts its extensive security services business in the United States through its wholly-owned subsidiary, ADT Securities Systems, a Delaware corporation. ADT is the largest single provider of central station monitoring security services in the United States, employing approximately 7,000 employees throughout the country. (JA438) Through its subsidiaries, ADT owns 55 offices in the United States. (JA462)

ADT's other principal business, conducting auctions for the sale and purchase of motor vehicles, employs approximately 3,100 persons in the United States on a full-time basis. (JA438) Thus, in total, ADT, through its wholly-owned subsidiaries, employs over 10,000 persons in the United States. (JA438, JA461)

LEP is a competitor of ADT in the United States, and, like ADT, is engaged extensively in the security and alarm services business, as well as the freight forwarding business. (JA741) LEP's security service business in the U.S. is conducted through its wholly-owned subsidiary the National Guardian Corporation ("National Guardian"), which is headquartered in Greenwich, Connecticut. National Guardian employs approximately 2,000 persons throughout the United States (JA690) and in 1989 had revenues of $200 million from its operations in the United States. (JA691)

LEP's securities trade in this country on the NASDAQ in the form of American Depository Shares ("ADS's"), representing American Depository Receipts ("ADR's") issued by an American depository in exchange for LEP's ordinary shares on deposit (each LEP ADR represents the bundling of five ordinary shares of LEP). (A7) As the Second Circuit

observed, there was a "direct linkage" between the trading price for LEP ordinary shares and LEP ADR's: "If the ordinary share price fell on the London Exchange, the market price of an ADR would decrease in similar manner, and vice versa." (A12) As a result of having registered its shares on the NASDAQ, LEP has subjected itself under Section 12(b)(1) of the Securities Exchange Act of 1934 [15 U.S.C. § 78l(b)(1)] to regular reporting requirements of the Securities and Exchange Commission (the "SEC").

LEP's investments in United States businesses include its substantial investment in real estate limited partnerships developing property in California and Nevada (JA692-96), and a trade finance company, Trading Alliance Corp. ("T.A.C."), headquartered in New York City. (JA697-99)

**ADT's Interest in Investing in LEP and Its Analysis of the Company**

ADT had acquired a relatively small amount of LEP securities as a result of the 1988 merger between LEP and National Guardian, in which ADT already held stock. ADT began to analyze potential further investments in LEP, with a view toward possibly acquiring National Guardian through an acquisition of LEP itself. (JA440-41)

In December, 1989, Michael Ashcroft, the Chairman of ADT, requested that Nicholas Wells, an ADT executive, undertake an evaluation of LEP in conjunction with Canadian Pacific, another company contemplating an investment in LEP. Wells had been hired by ADT to assist in managing its program of securities investments, and, as a result of his prior investment banking experience, was well-acquainted with techniques of valuation and investment analysis. (JA524-26)

Canadian Pacific had commissioned two companies to analyze and report on the business of LEP: S.G. Warburg, an investment bank, and LEK, a management consulting group. In December 1989 and January 1990, Nicholas Wells of ADT

met with representatives of Canadian Pacific, S.G. Warburg and LEK in order to discuss the reports produced by them, which had been provided to ADT. (JA526)

In performing his analysis of LEP, Wells, who was in charge of ADT's investigation of LEP, obtained and made extensive use of a report produced by S.G. Warburg (the "Report"). The Report was based heavily on LEP's filings with the SEC. As explicitly stated in the introduction to the Report:

> The analysis set out herein is based on publicly available information on [LEP], including recent U.K. annual reports and circular to shareholders, *the U.S. annual report on Form 20-F for the year ended 31st December, 1988 (the "Form 20-F")*, the company's shareholder register and brokers' reports. (JA534; emphasis added).

The Report given to Wells relied heavily on LEP's U.S. filings with the SEC, because as noted in the Report:

> In trying to analyze [LEP's] financial performance, the Form 20-F provides a more detailed description of the company's business activities than the U.K. accounts. (JA539)

The Report was not all that Wells studied. The disclosure documents themselves filed by LEP with the SEC in the United States were central to ADT's analysis of LEP. Wells was provided by Canadian Pacific with a copy of the LEP Form 20-F for the year ended 1988, which had been filed by LEP with the SEC on June 30, 1989. (JA594-670) As Mr. Wells stated in his affidavit before the District Court, "I regarded the LEP 1988 Form 20-F as highly significant for my analysis of LEP, as it was the most recent Form 20-F that had been filed by LEP." (JA527)

In March 1990, Canadian Pacific abandoned the idea of acquiring LEP jointly with ADT. ADT, however, remained

interested in exploring a strategic investment in LEP, and Mr. Wells continued his analysis of LEP. (JA527-28)

**ADT's Decision to Purchase LEP Stock**

David Hammond, Deputy Chairman of ADT, and Michael Ashcroft, the Chairman of ADT, conferred with ADT's Nicholas Wells regularly throughout the early part of 1990 regarding the progress of Mr. Wells' analysis of LEP and the conclusions he was formulating. (JA441-42, JA528)

In the Spring of 1990, Mr. Hammond discussed ADT's possible investment in LEP with Michael Ashcroft, the Chairman of ADT. Their discussion resulted in a decision that ADT would undertake a program of acquiring LEP stock. This decision was based largely on the analysis Mr. Wells had conducted of LEP, relying on LEP's U.S. filings with the SEC, such as its Form 20-F for 1988, and the Report commissioned by Canadian Pacific, which was also based on LEP's SEC filings. The contemplated stock acquisition program involved making purchases of LEP stock in the open market or through negotiated transactions as LEP stock became available, in such a way as to minimize the effect on the trading price of LEP stock. (JA442-43, JA672-73)

ADT decided to implement its purchase program through Itoba, one of its wholly-owned subsidiaries created to hold the investments of ADT. Itoba is a Channel Islands corporation formed by ADT to acquire and hold securities investments for ADT with funds provided by ADT. (*See* JA511-22.)[3]

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[3] Itoba's principal business, as disclosed in Schedules 13D filed by ADT with the SEC, is "to hold investments for A.D.T." (JA514) The significant investments by Itoba and ADT's other subsidiaries are identified in ADT's Annual Report and in its filings with the SEC as investments held *by ADT*, as opposed to the particular ADT subsidiary used to hold ADT's investment. For example, in ADT's Form 20-F for the year ended December 31, 1991, Itoba's investment in LEP is identified as an investment of ADT. (JA453)

In order to implement ADT's decision to invest in LEP, David Hammond contacted a member of the Itoba Board (which is elected by its sole shareholder, ADT), advised him of ADT's decision and recommended that Itoba acquire LEP stock on behalf of the ADT Group. Itoba adopted its parent corporation's recommendation ("[a]s expected," as the Second Circuit observed (A8)).

Itoba then implemented the ADT stock purchase program by contacting, in turn, William Grant, an ADT employee, and requesting that Mr. Grant commence making the purchases of LEP stock on behalf of Itoba. (JA686-87, JA444, JA672-73) Mr. Grant made the first purchase of LEP stock on June 4, 1990.

After the purchase program commenced, Mr. Wells continued his analysis of LEP. On or about June 29, 1990, LEP filed its Form 20-F for the year ended December 31, 1989. Mr. Wells obtained a copy of the 1989 Form 20-F in early July 1990, and he analyzed the disclosure contained in that Form 20-F to compare its information with that contained in the Form 20-F for the prior year (*i.e.*, 1988). Based upon this comparison, Mr. Wells concluded that there was no reason for ADT to abandon its ongoing program of acquiring LEP shares through Itoba (JA529), and the purchases continued.

**ADT's Purchase of 7,300,000 LEP Shares Held by Defendant William Berkley**

On October 8, 1990, ADT, through Itoba, purchased 7,300,000 LEP shares from petitioner William R. Berkley ("Berkley"), an American citizen and resident of Greenwich, Connecticut. David Hammond, ADT's Deputy Chairman, personally conducted the negotiation for this substantial purchase with Lehman Brothers Securities ("Lehman"), brokers he believed to be acting on behalf of Berkley. (JA445) As noted above, Berkley was a director of LEP and the president of its Connecticut subsidiary, National Guardian.

The Berkley transaction was set in motion when Berkley contacted his broker in Manhattan (New York & Foreign Securities Corporation) to arrange for the sale, which was cleared through Bear Stearns & Co. in New York. (JA705-06, JA59) Berkley's brokers, acting through Lehman's London branch, then contacted Mr. Hammond to inform ADT that 7,300,000 shares were being offered for sale by a United States-based holder of LEP stock. Through information from Lehman that the shareholder was based in the United States and was not selling his entire holdings of LEP stock, Mr. Hammond correctly concluded that the 7,300,000 shares that were being offered for sale were held by Berkley. (JA445) After negotiations with the broker over the price to be paid, Itoba purchased Berkley's 7,300,000 shares. Berkley, after paying his broker's commission, received $23,888,300 from the sale. (JA707-08, JA59)

With the purchase of the 7,300,000 shares from Berkley and several small purchases of LEP stock shortly thereafter, ADT suspended its purchase program in November 1990. ADT continued to analyze LEP for the purpose of considering whether to make a tender offer for LEP or otherwise to attempt to acquire National Guardian. (JA445)

Beginning in September, 1991 and continuing into 1992, LEP made a series of public disclosures that rocked the company and brought its stock value tumbling down. LEP disclosed for the first time that it had been making substantial, high risk investments and had engaged in previously undisclosed activities that were not central to its business. LEP wrote off $522 million in losses on its 1991 financial statements, a staggering result. (JA446, JA529-30) The most substantial part of the write-offs related to the previously undisclosed and unauthorized operation of a knitwear company conducted through LEP's New York-based trade finance subsidiary, T.A.C., and write-offs of its investment through the issuance of letters of credit in connection with real estate in California and Nevada.

LEP's current management has blamed former management for events that caused ADT's losses and has questioned the adequacy of prior public disclosures. At a meeting of LEP shareholders on August 24, 1992, David James, the new LEP Chairman, stated that it was "possible that the Board under my direction may wish to initiate legal actions regarding various matters which have led to a loss of shareholders' value in their Company" and (JA772-73) that "[s]hareholders may well feel it appropriate to enquire how such a series of calamities may have befallen their company in a relatively short period of time." (JA779) In response to a shareholder question at the meeting regarding non-disclosure in LEP's financial statements, Mr. James conceded that "the question of whether on occasions full and proper disclosure has been made is one which requires some subsequent and further review." (JA783)

The value of ADT's $114 million investment in LEP had plummeted to $2.26 million as of the commencement of this action in September, 1992, representing a loss of approximately $111 million. (A9) This loss was borne by ADT's numerous U.S. shareholders (A15), as ADT has written off on its own balance sheet the entire amount of its $114 million investment in LEP. (JA903)

In the wake of these disclosures, ADT decided to commence this action. The Complaint, filed on September 22, 1992 in the name of its subsidiary Itoba, asserts claims against all defendants pursuant to Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], to recover damages arising from defendants' fraudulent non-disclosure in filings made by LEP with the SEC. (JA38, JA42-44) In addition to the claims asserted against LEP and against its directors as Section 20(a) "controlling persons" under Section 10(b) and Rule 10b-5, Itoba asserts independent claims for federal securities violations against petitioner Berkley arising out of his personal sale of LEP securities for over $23 million. (A9)

### B. The Proceedings Below

Itoba commenced this action on September 22, 1992 in the United States District Court for the District of Connecticut. On February 4, 1994, a Magistrate Judge rendered a Recommended Ruling, recommending that the District Judge grant petitioners' motions to dismiss for lack of subject matter jurisdiction. (A22-35) On March 14, 1994, the District Judge, in a one-sentence Endorsement Order, over Itoba's objection adopted the Recommended Ruling of the Magistrate Judge. (A21)

On May 15, 1995, the Second Circuit, in a unanimous decision, reversed the District Court's order of dismissal, remanding the action to the District Court for further proceedings. Petitioners filed a petition for rehearing with a suggestion for rehearing *en banc*, which was denied by the Second Circuit on July 14, 1995. (A1-2) LEP Group plc, William R. Berkley and Peter J. Grant filed petitions for writ of *certiorari* on or about October 12, 1995; defendants John L. Read and John R. East have not sought *certiorari*. On October 12, 1995 and November 3, 1995, petitioners filed motions with the District Court to dismiss the action on the grounds of *forum non conveniens*. Those motions are pending.

## REASONS FOR DENYING THE WRIT

### I.

### IN VIEW OF THE SECOND CIRCUIT'S REMAND FOR FURTHER DEVELOPMENT OF JURISDICTIONAL FACTS, THE SUPREME COURT SHOULD NOT REVIEW THIS INTERLOCUTORY DECISION

The decision that petitioners urge this Court to review is interlocutory. In reversing the District Court's dismissal for lack of subject matter jurisdiction, the Second Circuit remanded for "a trial on the merits in which the facts relevant to jurisdiction may be more fully developed." (A18)

The Second Circuit also took particular note of the Magistrate Judge's erroneous factual findings on which the District Court had based its decision, including the erroneous finding that neither ADT nor Itoba had read and relied on LEP's SEC filings in making their purchase decision. (A11) Among the additional facts related to jurisdiction that the Second Circuit left for development on remand is whether the sale by Berkley of 7,300,000 shares of LEP stock through a New York broker and the purchase of such shares by Itoba on the same day was "coincidental."[4] (A16)

Thus, the Court is confronted with an interlocutory order based on a disputed and, in some respects, undeveloped factual record. The well-settled jurisprudence of this Court points clearly to the denial of *certiorari* to review such an order. *See Virginia Military Institute v. United States*, U.S. ___, 113 S.Ct. 2431, 2432 (1993) (Scalia, J., concurring) ("We generally await final judgment in the lower courts before exercising our *certiorari* jurisdiction"). Issuance of a writ of *certiorari* in cases presented for review of interlocutory orders is confined to instances in which review "is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause." *American Construction Co. v. Jacksonville, T. & K.W.R. Co.*, 148 U.S. 372, 384 (1893). "[E]xcept in extraordinary cases, the writ is not issued until final decree." *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916).

There is yet another procedural reason why the Court should decline to review the Second Circuit's interlocutory order—one which illustrates the wisdom of declining review of interlocutory orders. On October 12 and November 3, 1995, petitioners moved in the District Court for dismissal of this action on the ground of *forum non conveniens*. While

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[4] Itoba contended below that Berkley's sale and Itoba's purchase constituted effectively a direct sale from Berkley to Itoba; Berkley contended that he sold his shares on the market, to no purchaser in particular.

Itoba is opposing the motions, the District Court's determination could dispose of this action prior to the opportunity for review by this Court. Adherence in this case to the Court's general rule declining the review of interlocutory orders would prevent potentially unnecessary review by this Court. Petitioners, of course, will have the opportunity to seek a full review of any jurisdictional issues should the *forum non conveniens* motions be denied and a judgment in Itoba's favor be rendered at trial.

## II.

## PETITIONERS HAVE SKEWED THE RECORD TO OBSCURE SUBSTANTIAL CONDUCT AND EFFECTS WITHIN THE UNITED STATES

Not surprisingly, petitioners seek to characterize this action as entirely "foreign." (*See* Berkley Pet. at 4 ("foreign purchases of foreign securities on foreign exchanges . . ."); LEP Pet. at 2 (same).) However, the Second Circuit appropriately cut through petitioners' attempts to obscure the substantial conduct by defendants, and effects of defendants' actions, within the United States, which satisfy the well-settled "Conduct Test" and "Effects Test" for subject matter jurisdiction. The significantly domestic nature of the conduct and effects is apparent from the following facts recognized by the Second Circuit:

1. The alleged fraud culminated with LEP's filing with the SEC in Washington, D.C. of documents containing material misrepresentations and omissions. (A13) Thus, this is not the kind of case appropriately screened by the Conduct Test, in which defendants have engaged in a fraud abroad and, along the way, have engaged in some "merely preparatory" activity within the U.S. borders before the fraud is consummated abroad.

2. As discussed within, because LEP has elected to take advantage of U.S. markets by trading its securities on the NASDAQ (A7), LEP is required to make regular disclosures in filings with the SEC under Section 12(b)(1) of the Securities Exchange Act of 1934 [15 U.S.C. § 78l(b)(1)].

3. ADT sought out and relied on LEP's SEC filings in making its decision to invest over $100 million in LEP. (A11)

4. Consistent with its precedents focusing on the economic substance of a transaction for the determination of jurisdiction (*see Leasco Data Processing Equip. Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972)), the Second Circuit observed that the investment in LEP securities at issue was made, and the loss incurred, by Itoba's parent company, ADT, a company whose shares are listed on the New York Stock Exchange and roughly 50 percent of whose shareholders of record reside in the United States. (A7)

5. Perhaps the most glaring of petitioners' omissions is the absence of any discussion concerning the claim against petitioner William R. Berkley, a United States citizen working and residing in Greenwich, Connecticut, who was a director of LEP and the President of its U.S. subsidiary, National Guardian. His personal sale originating in Greenwich, Connecticut of over $23 million in LEP securities, which were purchased by Itoba, forms the basis of a sizeable portion of Itoba's claim for damages on its federal securities fraud claims. (A9, A16-17)

Such substantial conduct and effects within the United States, completely ignored by petitioners, satisfy the requirements for subject matter jurisdiction under the well-settled "Conduct Test" and "Effects Tests," as discussed in Point III.

## III.

## THERE IS NO CONFLICT AMONG THE CIRCUITS

In an attempt to create the appearance of a substantial conflict among the Circuits, petitioners, at great length, describe past applications of the "Conduct Test" and the "Effects Test" by different Circuits. (Berkley Pet. at 8-17.) However, more than anything else, petitioners' argument demonstrates not a conflict among the Circuits, but only differences in emphasis in their application of these tests.

All of the Circuits, without exception, apply a Conduct Test/Effects Test analysis for the determination of subject matter jurisdiction—an analysis originating in the Second Circuit's decision in *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969), and applied by the Second Circuit in this case. And in most cases, the result of the analysis by the different Circuits to a given set of facts would yield the same conclusion: either finding jurisdiction or finding it lacking.

Although various Circuit courts have developed somewhat different formulations of the Conduct Test/Effects Test, no "conflict" exists among the Circuits within the meaning applied by this Court. As a commentator of this Court's *certiorari* jurisprudence has observed, a conflict for the purposes of a *certiorari* petition "means that there must be a real or 'intolerable' conflict on the same matter of law or fact, not merely an inconsistency in dicta or in the general principles utilized." R. Stern *et al.*, *Supreme Court Practice*, § 4.3 at 167 (1993).[5]

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[5] *See, e.g.*, *United States v. Lorenzetti*, 467 U.S. 167, 173 (1984) (interpretation of federal statute by the Sixth Circuit and the Third Circuit was "squarely inconsistent"); *Ins. Corp. of Ireland v. Compagnie de Bauxites de Guinee*, 456 U.S. 694, 700 (1982) (Third Circuit's decision that a discovery sanction imposing finding of personal jurisdiction did not violate due process "directly conflict[ed]" Fifth Circuit decision); *see also Commissioner v. Scottish Amer. Inv. Co.*, 323 U.S. 119, 121 (1944) ("The irreconcilable conflict between the two courts below led us to grant certiorari.")

On repeated occasions, *certiorari* has been sought to review Circuit court decisions finding subject matter jurisdiction over federal securities fraud claims involving foreign aspects. In each case, this Court has denied *certiorari*.[6] And in *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied sub nom. Churchill Forest Industries (Manitoba) Ltd. v. Securities and Exchange Comm'n*, 431 U.S. 938 (1977), the petitioners sought *certiorari*, arguing, just as petitioners have in this case, that *certiorari* should be granted to resolve an alleged conflict between the Third, Second, Eighth and Ninth Circuits as to the proper standard for subject matter jurisdiction over federal securities fraud claims involving foreign elements. Yet, this Court denied *certiorari*. *Kasser*, *supra*, 431 U.S. 938 (1978).

Much of petitioners' argument relating to conflict is based on their claim that the Second Circuit, in *Itoba*, departed from its own restrictive Conduct Tests/Effects Test formulation, thereby expanding the continuum between those Circuits adhering to the most restrictive formulation and those adopting the most expansive. This suggestion is simply not so.

As petitioners concede, the Second Circuit jurisdictional test has always been among the most restrictive. In this case, the Second Circuit's discussion of the jurisdictional issue is mostly a pointed analysis of how the District Court misread critical facts before it on the jurisdictional motion. In discussing these facts in relation to the Conduct Test and Effects Test, the Court did not create a new formulation; it simply applied its tests to the facts before it.

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[6] *See Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *cert. denied sub nom. Manley v. Schoenbaum*, 395 U.S. 906 (1969). *SEC v. Kasser*, 548 F.2d 109 (3d Cir.), *cert. denied sub nom. Churchill Forest Industries (Manitoba), Ltd. v. Securities and Exchange Comm.*, 431 U.S. 938 (1977); *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.), *cert. denied*, 502 U.S. 1005 (1991); *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 730 F.2d 1103 (7th Cir.), *cert. denied*, 469 U.S. 871 (1984) (claims under the anti-fraud provisions of the Commodities Exchange Act).

In discussing the Conduct Test, the Court set forth its traditional formulation, citing *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied sub nom. Bersch v. Arthur Andersen & Co.*, 423 U.S. 1018 (1975) and *Alfadda v. Fenn*, 935 F.2d 475 (2d Cir.), *cert. denied*, 502 U.S. 1005 (1991). (A10) The Court then rejected the District Court's finding that LEP's United States-based activities did not "directly cause" Itoba's financial losses. (A11) Again applying its familiar test, the Second Circuit also found that the filing of fraudulent SEC filings in Washington, D.C. constitutes fraudulent activity in this country that is not "merely preparatory" to a fraud committed outside the United States. (A13-15) Nowhere did the Second Circuit say, or suggest, that it was changing its test or that Itoba failed to meet its traditional Conduct Test.

Similarly, in applying the Effects Test, the Second Circuit broke no new ground. Rather, the Court emphasized that the District Court erred in finding the Effects Test not met merely because Itoba, and not ADT, was the plaintiff. (A15-A16)

Much of petitioners' argument focuses on the Second Circuit's observation that, with respect to the Conduct Test and the Effects Test, "an admixture or combination of the two often gives a better picture of whether there is sufficient United States involvement to justify the exercise of jurisdiction by an American court." (A10) To suggest that this observation represents either a fundamental shift in Second Circuit jurisprudence, or a major change in subject matter jurisdiction jurisprudence when taken in context of other Circuit court decisions—all of which differ slightly in their formulation of the Conduct Test/Effects Test analysis—is to grossly exaggerate the implication of that observation.[7]

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[7] Even assuming *arguendo* that *Itoba* created a new formulation of the Conduct Test/Effects Test analysis, it is by no means clear that the formulation would expand jurisdiction. Just as elements which would not independently satisfy the Conduct Test or Effects Test might, in combination, produce a finding of jurisdiction, where a showing of *either* conduct or effects is particularly weak, a court might decline jurisdiction under *Itoba*.

Petitioners' conflict argument merely shows that in a particular case, subject matter jurisdiction theoretically could exist under the formulation of one Circuit and not the other. However, because of the substantial overlap of the Conduct Test/Effects Test analysis as applied in every Circuit, the nuances among the Circuits' formulations do not create a conflict that justifies granting *certiorari*.

Finally, whatever the differences among the Circuits, this case would serve as a poor vehicle for this Court to speak on the issue of subject matter jurisdiction. This is not a "close" case, in which one particular Circuit court's formulation would support jurisdiction while another's would preclude it. Because this case would pass muster under the most restrictive formulation (that applied by the Second Circuit and D.C. Circuit), there is no question that jurisdiction would be found in Circuits which, as petitioners recognize, have a more expansive view of jurisdiction.[8]

## IV.

## THE SECOND CIRCUIT'S DECISION WILL NOT OPEN THE FLOODGATES TO FEDERAL SECURITIES ACTIONS LACKING SUBSTANTIAL CONDUCT OR EFFECTS WITHIN THE UNITED STATES

Petitioners contend that:

> The Second Circuit decision threatens to open the doors of the United States courts to foreign purchasers of foreign securities on foreign exchanges that the United States has little interest in regulating.

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[8] Petitioners misleadingly suggest that the Second Circuit's reference to "questionable law" is a criticism of its own subject matter jurisdiction jurisprudence. (Berkley Pet. at 16.) As apparent from the context of the reference, the Second Circuit was merely referring to the Magistrate Judge's misapplication of Second Circuit precedent.

Berkley Pet. at 4. Indeed, petitioner LEP goes so far as to say:

> [T]he Court of Appeals has created a new doctrine under which any foreign corporation must anticipate that any purchaser of its securities, anywhere in the world, who received advice from anyone, American or not, which was derived in any manner and at any level of indirectness from information that appeared in an SEC filing, can sue in an American court, provided some shareholder of the purchaser (or as in this case a shareholder of the purchaser's corporate parent) is American.

(LEP Pet. at 10-11.)

Petitioners' dire prediction that this decision will produce a flood of Rule 10b-5 actions is sheer speculation, unsupported by any empirical evidence, and, of course, any history. Should this prediction prove true, there is time enough for this Court to revisit the issue, and to evaluate both the number of those filings and the quality of those actions when measured against the purposes underlying the U.S. securities laws. However, the reality is that the facts supporting jurisdiction in this case could not be alleged by the myriad, hypothetical plaintiffs who petitioners claim will flood this country's courts in the wake of the *Itoba* decision. Petitioners' arguments completely overlook the substantial conduct and effects within the United States in this case, which few putative Rule 10b-5 plaintiffs will be able to allege, let alone prove.

In their briefs below, petitioners made many of the same doomsday arguments they have made here. The Second Circuit correctly contrasted ADT's circumstances from those of the many plaintiffs that petitioners speculate will overwhelm our courts: "Unlike some securities actions brought to recover questionable damages on behalf of optimistically described classes, *we are met here with a single plaintiff which suffered direct substantial losses*." (A17; emphasis added) Similarly, the Second Circuit correctly distinguished

this case from a fraud on the market case in which a plaintiff would not allege actual reliance on SEC filings. (A14) Only the plaintiff who can allege facts showing actual reliance will find support in the holding in *Itoba* as a basis for subject matter jurisdiction.

Petitioners also suggest that a defendant's fraudulent filings with the SEC are an insufficient or unpredictable basis for subject matter jurisdiction. (See Berkley Pet. at 25 ("Any investor claiming that a foreign market was somehow influenced by an ADR filing would now be entitled to a United States forum.")) Petitioner LEP asserts that now "nearly every foreign transaction of securities involving a company with some connection to the United States will subject all parties to the transaction to the prospect of litigation in the United States." (LEP Pet. at 22.)

However, LEP is hardly "a company with some connection to the United States." LEP, through its wholly-owned U.S. subsidiary National Guardian, was one of the major providers of electronic security services in the United States. Moreover, LEP had taken the significant step of registering its securities on the NASDAQ, which the SEC treats for reporting purposes as a "national exchange." As petitioner LEP itself points out, the Securities Exchange Act of 1934 (the "Exchange Act"), in its statement of legislative purpose, expresses Congress' concern with the "national market system," citing 15 U.S.C. § 78b. (LEP Pet. at 12.) As a result of availing itself of the benefits of trading on the NASDAQ, LEP was required to register its ADR's with the SEC pursuant to Section 12(b)(1) of the Exchange Act [15 U.S.C. § 78(l)(b)(1)].[9]

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[9] By registering its securities on the NASDAQ, LEP lost the benefit of an exemption for registration enjoyed by many foreign corporations whose securities trade in this country as ADR's *but do not trade on a national exchange*. Section 12(g) of the Exchange Act [15 U.S.C. § 78l(g)]and the regulations thereunder provide a lower tier "information-supplying" exemption for companies whose securities do not trade on a national exchange. This exemption establishes a system of supplying

There is nothing inappropriate, unbounded or unpredictable about subjecting to the anti-fraud provisions of the federal securities laws a company that has elected to register its securities on a U.S. national market system like the NASDAQ. Companies with "merely some connection to the United States," for whom LEP purports to express concern, need not fear being haled into the U.S. courts in the wake of the *Itoba* decision.

Petitioners also suggest that the holding in this case would allow jurisdiction so long as "some shareholder of the purchaser (or as in this case, of the purchaser's corporate parent) is American." (LEP Pet. at 11.) Jurisdiction was not found merely because "some shareholder . . . [was] American." The Second Circuit found that [h]ere, we have fraud occurring on an American exchange that has impacted detrimentally *upon thousands of United States shareholders* in the defrauded company, *i.e.*, over $100 million lost in the shareholders' corporate equity." (emphasis supplied) (A15) Allowing jurisdiction on these facts will not open the floodgates to litigation.

If anything, the Second Circuit's analysis in *Itoba* ensures that subject matter jurisdiction will not be found in cases lacking significant conduct in, or effects within, the United States. By considering an "admixture or combination" of the

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information that is less rigorous than the periodic reporting requirements of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] to which LEP is subject. When a foreign issuer has its ADR's listed for trading on NASDAQ, as LEP has done, it becomes subject to the more rigorous reporting requirements under Section 13(a) of the Exchange Act. The "information-supplying" exemption was made unavailable to foreign issuers whose securities trade on NASDAQ because:

> [T]he [SEC] believes that foreign securities included in NASDAQ should be regarded prospectively as voluntarily seeking U.S. trading markets and hence should be denied the information supplying exemption.

Securities Act Release No. 6493, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,435 at 86,295 (Oct. 6, 1983).

Conduct Test and the Effects Test (A10), the Court can decline jurisdiction if there is a troubling gap in the level of either U.S. conduct or U.S. effects.

## V.

## THIS COURT SHOULD NOT GRANT *CERTIORARI* BASED ON LEP'S SUGGESTION THAT THERE SHOULD BE NO EXTRATERRITORIAL APPLICATION OF THE FEDERAL SECURITIES LAWS

Not content with suggesting a conflict among the Circuits, LEP asserts that the federal securities laws should never be given extraterritorial effect. (LEP Pet. at 11-12.) This argument would overturn not only the decision in this case, but would reverse the law of all the Circuits, which, without exception, determine the existence of subject matter jurisdiction under the Conduct Test/Effects Test analysis.

The characterization of the jurisdictional issue as the "extraterritorial" application of the U.S. securities laws is somewhat of a misnomer to the extent it implies that a federal court would exercise jurisdiction over a purely foreign dispute. Traditionally, the term has been applied to disputes in which *some*—not all—of the relevant conduct or transactions has occurred abroad; were the conduct or transactions at issue to be entirely "extraterritorial," the issue of purported U.S. jurisdiction would never arise. Therefore, in any given case, the issue is not whether the court should exercise jurisdiction over a purely foreign dispute, but whether the conduct or effects within the United States are sufficient to justify the assertion of jurisdiction.

LEP bases its argument against any extraterritorial application of the federal securities fraud laws on its assertion that "[t]he language of the Exchange Act does not directly disclose any intention to give it extraterritorial affect [sic]" (LEP Pet at 11.) In *Tamari v. Bache & Co. (Lebanon) S.A.L.*, the

petitioners for *certiorari* made the same argument LEP makes in this case, and this Court denied *certiorari*. See *Tamari v. Bache & Co. (Lebanon) S.A.L.*, 469 U.S. 871 (1984) (*certiorari* petition argued that the Seventh Circuit had erred by applying the Conduct Test and Effects Test).

Through the development of the Conduct Test/Effects Test analysis, the Circuit courts, led by the Second Circuit, have applied the federal securities laws to provide a remedy for fraudulent conduct in this country injuring foreigners (so long as that conduct is not "merely preparatory" to the fraud), and fraudulent conduct causing a "substantial effect" within the United States. *See generally, Alfadda, supra,* 935 F.2d at 478. The Second Circuit, followed by every Circuit Court considering the question, has applied a Conduct Test/Effects Test analysis so that American courts would not be powerless to prevent "the United States [from] be[ing] used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners." *IIT v. Vencap.*, 519 F.2d 1001, 1017 (2d Cir. 1975). Petitioners point to no substantial source of dissatisfaction from the Congress, the courts or any of the foreign governments for whom petitioners express concern. Twenty-five years of this settled and workable jurisprudence should not be lightly cast aside.

## CONCLUSION

For the foregoing reasons, the Petitions for Writ of *Certiorari* filed by LEP Group plc, William R. Berkley and Peter J. Grant should be denied.

Respectfully submitted,

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